S. Hrg. 99-534, Pt. 2

THE COST AND AVAILABILITY OF LIABILITY INSURANCE FOR SMALL BUSINESS

HEARINGS

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

THE COST AND AVAILABILITY OF LIABILITY
INSURANCE FOR SMALL BUSINESS

PART 2

WASHINGTON, DC—FEBRUARY 20 AND 21, 1986

Printed for the use of the Committee on Small Business

U.S. GOVERNMENT PRINTING OFFICE
60-327 O WASHINGTON : 1986

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

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60-327 O - 86 - 1(Pt.2)

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CONTENTS

Statement of Senators:

Page

Weicker, Hon. Lowell, Jr., a U.S. Senator from the State of Connecticut, and chairman, Senate Small Business Committee 259

Kasten, Hon. Robert W., Jr., a U.S. Senator from the State of Wisconsin ... 262

Bumpers, Hon. Dale, a U.S. Senator from the State of Arkansas 263

Trible, Hon. Paul S., Jr., a U.S. Senator from the State of Virginia 265

Sasser, Hon. James R., a U.S. Senator from the State of Tennessee 266

Gorton, Hon. Slade, a U.S. Senator from the State of Washington 272

D'Amato, Hon. Alfonse, a U.S. Senator from the State of New York 272, 559

Dixon, Hon. Alan, a U.S. Senator from the State of Illinois 277, 562

Harkin, Hon. Tom, a U.S. Senator from the State of Iowa 312

Levin, Hon. Carl, a U.S. Senator from the State of Michigan 533

Pressler, Hon. Larry, a U.S. Senator from the State of South Dakota 551

Nickles, Hon. Don, a U.S. Senator from the State of Oklahoma 633

Statement of:

Baldwin, M. Dana, II, president, Oliver Machinery Co., Grand Rapids, MI. 340

Bowman, Hon. Woods, representative, Illinois House of Representatives, Evanston, IL 679

Brine, William H., president, W. H. Brine Co., Milford MA; representing the Sporting Goods Manufacturers Association 431

Carroll, Francis R., president, Small Business Service Bureau, Inc., Worchester, MA 601

Coleman, Daniel J., owner, Powerscourt and Dubliner Restaurants, Washington, DC 587

Ehrnman, Karen, coordinator of Government relations, American College of Nurse Midwives, Washington, DC 403

Green, Kenneth, president, Oklahoma Liquefied Gas Co., Seminole, OK 626

Gullickson, William, Jr., general manager/treasurer, McLaughlin, Gormley, King Co., Minneapolis, MN 568

Habush, Robert L., attorney, Milwaukee, WI; representing the Association of Trial Lawyers of America 486

Hess, Dr. Earl H., president, Lancaster Laboratories, Inc., Lancaster, PA; representing the U.S. Chamber of Commerce 318

Lienhart, James, vice president in charge of operations, Arrow Coach Lines, Little Rock, AR 619

Lipshie, Norman W., managing partner, Weber, Lipshie & Co., New York, NY; representing the New York State Society of Certified Public Accountants 421

Martin, Steve, vice president for Government relations, the Hartford Insurance Group, Hartford, CT; representing the American Insurance Association 469

Muhl, Edward J., insurance commissioner, State of Maryland, Baltimore, MD 664

Neely, L. S., president, Trackmobile, Inc., LaGrange, GA 313

Nystrom, Michael L., president, Aerostar International, Inc., Sioux Falls, SD 566

Polk, John J., executive director, Council of Smaller Enterprises, Cleveland, OH 544

Sanders, Hon. James C., Administrator, U.S. Small Business Administration 279

Silverman, Judy J., codirector, Jackson Child Care Program, Inc., New Haven, CT 372

Simons, S. Brian, president, OEM Controls, Inc., Shelton, CT 355

Statement of—Continued
Page
Temp, James A., managing vice president, Alexander & Alexander Services, Inc., Green Bay, WI; on behalf of the National Association of Insurance Brokers 446
Young, Robert, vice president, Ireland and Bellingar, Inc., Bellingham, WA; representing the Independent Insurance Agents of America 441
Zehnder, William A., general manager, Frankenmuth Bavarian Inn, Frankenmuth, MI 632

APPENDIX

Letter dated February 18, 1986, to Tract Crowley, hearing clerk, from Mat Bockh, Teltex Inc., North Branford, CT 720
Statement of William R. Deutsch, executive vice president, Illinois Petroleum Marketers Association, Springfield, IL 721
Statement of William M. Quinn, chairman, Government Affairs Council, American Supply Association, Chicago, IL 744
Statement of John Russell Dean III, law offices of Deane, Snowdon, Shutler & Gherardi, Washington, DC 755
Statement of Ed D. Ligon, Jr., president, Orbit Valve Co., Little Rock, AR 758
Statement of Michael A. Hatch, commissioner, Department of Commerce, State of Minnesota, St. Paul, MN 761
Statements of Armand B. Ball, executive vice president, American Camping Association, Martinsville, IN, and Alan Stolz, Camp Cody, West Ossipee, NH 771
Statement of the National Association of Professional Insurance Agents [PIA] 777
Statement of Louis L. Guy, Jr., P.E., Guy and Davis, Consulting Engineers; on behalf of the National Society of Professional Engineers and American Academy of Environmental Engineers 790
Statement of Maria Dennison, vice president, Sporting Goods Manufacturers Association 795
Letter dated March 4, 1986, from Philip P. Friedlander, Jr., executive vice president, National Tire Dealers & Retreaders Association, Inc., to Senator Weicker 801
Statement of the National LP-Gas Association, Arlington, VA 804
Statement of Beverly E. Hauschild, executive director, the American Institute of Architects, Minneapolis, MN 830

HEARING DATES

February 20, 1986:
Morning session 259
February 21, 1986:
Morning session 551

THE COST AND AVAILABILITY OF LIABILITY INSURANCE FOR SMALL BUSINESS

THURSDAY, FEBRUARY 20, 1986

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The committee met, pursuant to recess, at 9:40 a.m., in room 428A, Russell Senate Office Building, Hon. Lowell Weicker, Jr. (chairman of the committee) presiding.

STATEMENT OF HON. LOWELL WEICKER, A U.S. SENATOR FROM THE STATE OF CONNECTICUT, AND CHAIRMAN, SENATE SMALL BUSINESS COMMITTEE

The CHAIRMAN. Good morning.

Today the committee continues its examination of the impact of the current liability insurance crisis on small business. The ability of small firms to obtain affordable liability insurance, and in many cases to secure coverage at any price, is threatening this Nation's small business sector. Faced with premium rate hikes as high as 1,000 percent, many small businesses are forced to either go bare or simply shut their doors.

The committee's mailbox is crammed with letters detailing horror stories of forced closings or business cutbacks resulting in the loss of products and services vital to our economy. Firms like OEM Controls of Shelton, CT, and Jackson Child Care Program of New Haven well illustrate the hardships facing small firms due to the insurance crunch.

The rest of my statement will be included in the record.

[The prepared statement of Senator Weicker follows:]

OPENING STATEMENT OF SENATOR LOWELL WEICKER, JR.
ON
LIABILITY INSURANCE HEARING

FEBRUARY 20, 1986

TODAY, THE COMMITTEE CONTINUES ITS EXAMINATION OF THE IMPACT OF THE CURRENT LIABILITY INSURANCE CRISIS ON SMALL BUSINESS.

THE ABILITY OF SMALL FIRMS TO OBTAIN AFFORDABLE LIABILITY INSURANCE, AND IN MANY CASES TO SECURE COVERAGE AT ANY PRICE, IS THREATENING THIS NATION'S SMALL BUSINESS SECTOR. FACED WITH PREMIUM RATE HIKES AS HIGH AS ONE THOUSAND PERCENT, MANY SMALL BUSINESSES ARE FORCED TO EITHER GO "BARE", OR SIMPLY SHUT THEIR DOORS.

THE COMMITTEE'S MAILBOX IS CRAMMED WITH LETTERS DETAILING HORROR STORIES OF FORCED CLOSINGS OR BUSINESS CUTBACKS RESULTING IN THE LOSS OF PRODUCTS AND SERVICES VITAL TO OUR ECONOMY. FIRMS LIKE OEM CONTROLS, INC. OF SHELTON, CONNECTICUT AND JACKSON CHILD CARE PROGRAM OF NEW HAVEN WELL ILLUSTRATE THE HARDSHIPS FACING SMALL FIRMS DUE TO THE INSURANCE CRUNCH.

AT PRESENT, MANY CONGRESSIONAL COMMITTEES ARE HOLDING HEARINGS ON THIS INSURANCE CRISIS. OVER THE NEXT TWO DAYS, THIS COMMITTEE WILL RECEIVE TESTIMONY FROM REPRESENTATIVES OF THE INSURANCE INDUSTRY, TRIAL LAWYERS, AND STATE REGULATORS AND LEGISLATORS, ABOUT THE CAUSES AND POSSIBLE SOLUTIONS TO THE CURRENT SITUATION AND WHETHER ANY FEDERAL ACTION IS APPROPRIATE OR NECESSARY.

I AM PLEASED THAT SENATOR KASTEN HAS AGREED TO CHAIR TODAY'S HEARING. SENATOR KASTEN HAS BEEN THE LEADER IN LEGISLATIVE EFFORTS TO ESTABLISH A FEDERAL UNIFORM PRODUCT LIABILITY STANDARD. WHILE THE FOCUS OF TODAY'S HEARING IS BROADER THAN THE SPECIFIC PROBLEMS OF PRODUCT LIABILITY MANY OF TODAY'S WITNESSES WILL ADDRESS THE NEED FOR CONGRESS TO MOVE IN THIS AREA. I LOOK FORWARD TO WORKING WITH SENATOR KASTEN AND OTHER MEMBERS OF THIS COMMITTEE, AS WE STRUGGLE TO DEAL WITH THIS SERIOUS PROBLEM.

The CHAIRMAN. I'm going to turn the gavel over to someone who has been in the forefront of trying to resolve the problems facing the industry, Senator Kasten of Wisconsin.

This is an issue which Senator Kasten spotlighted long before it became of the intensity that it is today. Indeed, it seems to me that a good legislator is one who anticipates crisis, doesn't react to it, and that is exactly the situation that Senator Kasten enjoys vis-a-vis the liability problems that confront the Nation today.

The gavel will now be turned over to Senator Kasten for his statement and the statements of my good friend, the ranking member, Senator Bumpers, and others, and then we will hear from our first witness.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN [acting chairman]. Thank you, and thank you for your comments.

Today this committee continues an examination of one of the most critical problems the country faces today—the increasing scarcity and rising cost of liability insurance. This is a matter of great concern to this committee, which has received an alarming number of reports, as the chairman referred to some of the mail, about businesses that are having difficulties in obtaining liability insurance or, in fact, are unable to get liability insurance.

Affordable and readily available insurance is essential to small businesses and the operation of our economy. Without it, consumers must pay higher prices for needed goods and services; companies are forced out of business and jobs are lost; and product innovation and technological development is discouraged.

Every time I go back to Wisconsin I hear story after story of skyrocketing insurance rates and of solid companies that must "go bare" because they can no longer obtain liability cover. The story is usually the same or basically the same. A well-established company that has not had a major judgment against it suddenly finds itself faced with a premium increase that is so high that the firm must go bare, discontinue operations, or transfer operations outside the United States.

Because of the urgency of this problem and its impact on all Americans, Members of Congress are now seeking solutions to the insurance crisis. We've got hearings going on at this time in the Commerce Committee. Senator Danforth chaired a set of hearings yesterday. I'll be chairing a set of hearings next week. We've got hearings going on in the Small Business Committee. What we have really is an explosion taking place on the part of the public of great concern, and the Congress, I believe, is going to act, and we're going to act in a positive manner.

We approach the problem with different views as to its causes but with a common objective. There are those like myself who regard the tort system as the primary cause of the problem, because of its costs and unpredictability, while others focus more on insurance industry practices and performance. To be sure, the immediate cause of the shortages and price hikes that plague liability insurance buyers today is the exceptionally severe cyclical down-turn in the insurance market. Moreover, this market cycle may have been affected by faulty underwriting and pricing decisions by some insurance, but the problem of the availability and cost of liability insurance must be addressed with tort reform.

It's my view that one of the most important actions we can take to provide long-term relief for those unable to obtain liability insurance is to implement tort reform, particularly product liability reform. I've been working toward that goal for a number of years, as the chairman indicated.

In addition, I, along with Senator Danforth and other members of the Senate Commerce Committee, are preparing legislation which we believe can provide some immediate relief to those affected by the current crisis in liability insurance.

Our proposal would amend the Product Liability Risk Retention Act of 1981 to make it easier for other enterprises to perform collective purchasing groups and interstate risk retention groups for general liability coverage without imposing on them the conflicting requirements in each State in which they operate.

This proposal is not intended as a cure-all for the liability insurance problem. It would only facilitate the ability of others seeking general liability coverage to obtain favorable rates or to self-insure as part of a risk retention group. It does so only by preempting State laws that prevent the group purchase of such insurance and other State insurance laws to the extent necessary to permit the interstate operation of risk retention groups.

Of course, I recognize that small businesses are less able to protect themselves by self-insuring or contributing to a group insurance pool, because they've got less working capital than large firms and are less able to set aside reserves to cover claims or to contribute to a group insurance pool. But it is my hope that expanded use of the Risk Retention Act will aid those enterprises with sufficient capital. And it is also my hope that with product liability reform we will be able to address the insurance problem on a broader scale.

Small business and our entire society depends upon insurance. This morning we will hear more about the impact of the current insurance crisis on small business and hopefully we will gain greater insight into the problem.

We have today a distinguished group of witnesses. Before we begin with our lead witness, the Administrator of the Small Business Administration, I would like to ask if the Senator from Arkansas has any opening comments as ranking member of the committee.

STATEMENT OF HON. DALE BUMPERS, A U.S. SENATOR FROM THE STATE OF ARKANSAS

Senator BUMPERS. Mr. Chairman, thank you very much.

I want to begin by thanking Chairman Weicker for calling the hearings and the Senator from Wisconsin and the Senator from South Dakota for their invaluable assistance. Their attempts to find a solution has led to a great deal of needed information about the insurance industry and the many causes of the present crisis.

The present crisis, which has so limited the availability of insurance coverage for all kinds of small businesses across the country, is absolutely untenable. Although there are many explanations given for the current "hard" or "seller's" insurance market, there is no excuse for a situation which has profitable and socially important businesses operating with no insurance at all, or paying premiums at a level far beyond their capacity or, at worst, driving necessary service companies completely out of business.

There is, of course, more than one cause, but I do believe it is up to the insurance industry to justify these precipitous increases. I have received countless letters, as have all of my colleagues, from businesses in my State, from manufacturers, bus companies, and even county sheriffs, who complain that their insurance premiums for this year are anywhere from 50 to 600 percent higher than last year, or that they don't think they will be able to insure at all.

I would like to insert in the record a letter from Ed Ligon, president of the Orbit Valve Co. in Little Rock. Orbit is a small, high-tech company which produces precision valves used by the oil industry and for other purposes. They are an excellent corporate citizen. Like many others, he explains that his company's insurance policy was canceled in midterm earlier this year, without explanation, and that he only regained coverage upon the intervention of the State insurance commissioner.

His new policy is six times as costly as the previous one, and the coverage has been reduced by one-third. He also says that the company is regularly named in personal injury lawsuits even though the company has not been found at fault for any injury in over 10 years.

Should Orbit Valve, which has been a very successful Arkansas company for over three generations, have to fall victim to the present crisis? The answer is clearly no, and we are here today to find reasons for both problems facing the insurance industry and small business, and, hopefully, move toward some viable solutions to the problem.

Incidentally, I was on an airplane Sunday evening coming back with a small manufacturer in my home State that employs 35 people and who has had one lawsuit filed against the company since it was formed many, many years ago and was found innocent in that case, and yet his premium went up fourfold and his coverage went down fourfold. His coverage went from 6 million to 1.5 million while his premium went up 400 percent.

In attempting to clarify the causes for the current crisis, it seems to me that there are three problems. First, some of the problem is attributable to the cyclical nature of the insurance business. The price war which has characterized the past few years of rate setting led to a greater dependence on investment income, which is called "cash-flow underwriting." Investments were then threatened by falling interest rates and the insurance companies began turning up short on funds. This problem may be the result of lax oversight by the State insurance commissioners and the companies themselves.

Second, it seems to me that many carriers have overreacted to litigation. For example, an enormous scare has been brought about by the prosecution and lawsuits surrounding a single tragic episode in California. But I understand that although some lower court in California has held that the insurer may be liable for the criminal actions of one of its insureds, this decision has not yet been upheld on appeal, and I do not know whether it is likely to be upheld under California law.

I do know, however, that this is a fairly radical departure in the law, and I am skeptical that it will ever represent the law in most American jurisdictions. And yet we are told that day care centers are totally unable to secure liability coverage of any kind. It is difficult for me to see any real justification in the insurers' conduct on this point, unless the real purpose is to frighten citizens and politicians into overhauling the judicial system.

Finally, there have been many jury verdicts in personal injury cases which do, indeed, seem excessive, and it may be that there should be some reforms in the law of personal injury. I am generally a strong believer in the jury system. It is enshrined in the seventh amendment to the Constitution, and I do not want to see it undermined. Perhaps there are reforms which should be made in the tort system, such as statutes of repose or shortening of the statutes of limitations, but aren't the State legislatures competent to make such judgments about their own citizens?

The problem is real and it is complex. I don't think the solutions will be elicited from a heated exchange between the insurers, the business people, and the lawyers all pointing a finger at one another. It is impossible to point out one single cause for the present crisis, but it is possible to find one important solution, or at least the beginning of a solution, within the insurance industry itself. I don't think innocent victims should suffer from a hasty decision to change tort laws or set jury verdict limits when the problem may be best solved by making needed improvements in the insurance system first.

Thank you, Mr. Chairman.

Senator **Kasten**. Thank you, Senator.

Senator Trible.

STATEMENT OF HON. PAUL S. TRIBLE, JR., A U.S. SENATOR FROM THE STATE OF VIRGINIA

Senator **Trible**. Mr. Chairman, let me simply add a few words to what has been said by you and our other colleagues.

As you have correctly said, businesses today, large and small, are finding the cost of insurance escalating out of sight, and often insurance coverage is simply unattainable at any price.

What surprises me is the number of people that I find that are talking about this problem in town meetings and other sessions of my constituents around Virginia. More and more people are talking about the insurance crisis. I am prepared to talk about events in Central America or the budget battles here in Washington, and yet people are focusing my attention on the real need, the desperate need, they have as business men and women to find adequate insurance protection.

So I welcome this hearing and the hearings that are underway in the Commerce Committee on which we serve, and hope that these hearings will build a hearing record on which we can thoughtfully and dispassionately determine what ought to be done.

I applaud your leadership.

Senator **Kasten**. The Senator from Tennessee, Mr. Sasser.

STATEMENT OF HON. JAMES R. SASSER, A U.S. SENATOR FROM THE STATE OF TENNESSEE

Senator **Sasser**. Thank you.

Before moving into my statement, let me just add a word of appreciation to the fine work that Jim Sanders has done over the past few years. In what have been very difficult times for the Small Business Administration, Mr. Sanders, I think, and we'll all concede, has done an excellent job, and I wish him well as he leaves the Small Business Administration.

Mr. Chairman, I have a more extensive statement on this subject which I will submit for the record, but these 2 days of hearings on the cost and availability of insurance are vital to our effort to combat insurance costs. There's still a considerable dispute over the true nature and extent of the problem.

I chaired the first field hearings of this committee on this issue in November of last year in my native State of Tennessee and found several schools of thought on the reasons for the insurance crunch.

Tennessee's commissioner of insurance, for example, suggested that the cases of huge premium increases were exceptional. He stated the best course of action during this crisis was simply to let the market run its course. Needless to say, none of the small business owners who testified as those hearings agreed with the views of the commissioner of insurance.

In an effort to resolve this conflict and gather some more information about insurance problems, I conducted an informal mail survey of Tennessee's small business community in an effort to determine just how extensive the problem was. The results of the survey were quite troubling. Forty percent of the respondents have seen their premiums increased by more than 100 percent. Twenty-two percent of the respondents reported increases of between 100 and 250 percent, and a very disturbing 18 percent of those who responded said that their premiums had increased by more than 250 percent over the previous year, and almost all were saying that these premium increases came on top of shrinking coverage.

Those who answered my questionnaire made it clear that we simply—or they simply—could not afford to sit by and wait for the market to correct this situation. Seventy-five percent of those who responded to my survey are experiencing reduced profits because of increased liability costs. Ten percent of those who responded are considering going out of business because of the high cost of liability coverage, and 10 percent are going to stay out of business but state they will forego any insurance coverage at all.

So, clearly, corrective steps need to be taken to prevent further injury and further economic injury to the small business community. Now much can be done, and rightly should be done, at the State level. I think the setting of interim rates and establishing assigned risk pools are but two steps which are left to the States to protect small business. But, in my judgment, this doesn't mean the Federal Government should simply sit out this whole problem.

We are exploring several areas where Federal action, I think, is warranted. One such area that I believe worthy of further consideration involves possible antitrust violations. While property and casualty insurers are generally exempt from Federal antitrust laws, I'm exploring several possible courses of action here. If the allegations of some that the entire insurance crisis is part of a big business effort to achieve certain statutory reforms proves true, we may have to rethink the antitrust exemptions presently allowed property and casualty insurers.

So I look forward today to hearing what our witnesses have to say on these various points and will be speaking out, Mr. Chairman, on this important issue in the days ahead.

Thank you.

[The prepared statement of Senator Sasser follows:]

STATEMENT OF SENATOR JIM SASSER, SENATE COMMITTEE
ON SMALL BUSINESS

FEBRUARY 20, 1986

MR. SASSER: MR. CHAIRMAN, BEFORE GOING FURTHER WITH MY STATEMENT, I WANT TO ADD TO THE REMARKS OF OTHERS ON THE DEPARTURE OF JIM SANDERS AS ADMINISTRATOR OF THE SMALL BUSINESS ADMINISTRATION. MR. SANDERS HAS STOOD FIRM AS FRIEND TO SMALL BUSINESS THROUGHOUT HIS TENURE AT SBA. THIS HAS NOT BEEN AN EASY TASK GIVEN THE ADMINISTRATION'S CALLS FOR ELIMINATING THE SBA. I HAVE APPRECIATED MR. SANDERS WILLINGNESS TO WORK WITH ALL MEMBERS OF THIS COMMITTEE AND CONGRATULATE HIM ON A JOB WELL DONE.

MR. CHAIRMAN, TODAY'S HEARINGS CONTINUE THIS COMMITTEE'S EFFORTS TO COMBAT THE INSURANCE CRISIS WHICH HAS GRIPPED OUR SMALL BUSINESS COMMUNITY. I WAS PROUD TO CHAIR THE FIRST HEARINGS OF THIS COMMITTEE ON THIS IMPORTANT ISSUE LAST YEAR IN MY HOME STATE OF TENNESSEE. AS I AM SURE WE WILL HEAR TODAY, THE WITNESSES AT MY FIELD HEARINGS POINTED OUT THAT THE BOOM-AND-BUST NATURE OF THE INSURANCE INDSUTRY AND THE VICIOUS PRICE WARS OF THE LATE 70'S AND EARLY 80'S CONTRIBUTED MIGHTILY TO TODAY'S PROBLEMS. INTERESTINGLY ENOUGH, THE WITNESSES ALSO STATED THAT ANOTHER SOURCE OF TROUBLE WAS THE INCREASING ROLE OF CORPORATE CONGLOMERATES IN THE PROPERTY CASUALTY INSURANCE BUSINESS. BUYING INSURANCE COMPANIES FOR PREMIUM DOLLARS OR UNDERWRITING LOSSES, THESE CORPORATE GIANTS OFTEN LACKED THE EXPERTISE TO RUN A SOUND OPERATION.

THERE WAS SOME DISAGREEMENT OVER HOW EXTENSIVE THIS CRISIS WAS AND WHAT SHOULD BE DONE ABOUT IT. TENNESSEE'S COMMISSIONER OF INSURANCE SUGGESTED THAT COMPANIES WITH MASSIVE PREMIUM INCREASES WERE EXCEPTIONAL CASES. HE ALSO URGED THAT WE LET THE MARKETPLACE CORRECT ANY PROBLEMS CREATED BY THE HIGH COST OF INSURANCE. MANY OF THE SMALL BUSINESS OWNERS WHO TESTIFIED TOOK EXCEPTION WITH THESE VIEWS.

TO RESOLVE THIS CONFLICT AND TO EXPLORE THE VARIOUS ASPECTS OF THE INSURANCE CRISIS, I CONDUCTED AN INFORMAL SURVEY ON SMALL BUSINESS INSURANCE COSTS IN TENNESSEE. THIS SURVEY UNDERSCORED THE TROUBLING POINTS RAISED BY THE SMALL BUSINESS OWNERS DURING MY FIELD HEARING. A SIGNIFICANT PERCENTAGE OF TENNESSEE'S SMALL BUSINESSES HAVE SEEN THEIR INSURANCE PREMIUMS INCREASE BY MORE THAN 100%. SOME 22% OF THE RESPONDENTS TO MY SURVEY REPORTED PREMIUM INCREASES BETWEEN 100 - 200%. ANOTHER 18% RESPONDED THAT THEIR PREMIUMS HAD SHOT UP BY MORE THAN 250%.

MOST SMALL BUSINESS OWNERS WHO RESPONDED TO MY SURVEY ARE STILL ABLE TO FIND INSURANCE. 67% OF THOSE REPONDING ANSWERED THAT THEIR INSURANCE COVERAGE WAS STILL IN EFFECT. MANY OF THE RESPONDENTS HAVE BEEN FORCED TO SHOP AROUND FOR COVERAGE AS THEY WERE EITHER CANCELLED OR TURNED DOWN BY ONE INSUROR BEFORE FINDING A COMPAYN WILLING TO WRITE A POLICY. WHEN A POLICY WAS

FOUND, SOME 21% OF THE RESPONDENTS HAD TO ACCEPT REDUCED INSURANCE COVERAGE.

THESE MEN AND WOMEN MADE IT ABUDANTLY CLEAR THAT THEY CANNOT SIMPLY SIT AND WAIT FOR MARKET CORRECTIONS. NEARLY 75% OF THE RESPONDENTS TO MY SURVEY ARE EXPERIENCING REDUCED PROFITS BECAUSE OF INCREASED LIABILITY COSTS. TEN PERCENT ARE CONSIDERING GOING OUT BUSINESS ALTOGETHER AND TEN PERCENT ANTICIPATE STAYING IN BUSINESS, BUT GOING BARE, THAT IS FOREGOING INSURANCE COVERAGE. NALL ACROSS THE NATION.

PUT SIMPLY, MANY SMALL BUSINESS OWNERS AND THOSE WHO ARE INTERESTED IN THE WELL-BEING OF THE SMALL BUSINESS COMMUNITY BELIEVE THAT THE TIME FOR WAITING HAS PASSED. ACTION IS NEEDED NOW. MANY CORRECTIVE STEPS CAN AND RIGHTLY SHOULD ONLY BE TAKEN AT THE STATE LEVEL. FOR EXAMPLE, NEARLY 40% OF THE RESPONDENTS TO MY SURVEY BELIEVE THAT INTERIM PREMIUM RATES SHOULD BE SET BY STATE OFFICIALS TO GUARD AGAINST OVERLY STEEP PREMIUM INCREASES. OTHER ACTIONS AT THE STATE LEVEL, SUCH AS CREATING MORE ASSIGNED RISK POOLS, WERE ALSO URGED. AND AS LONG AS INSURANCE REMAINS A MATTER PRIMARILY OF STATE REGULATION, IT IS APPROPRIATE TO TURN TO THE STATES FOR THIS TYPE OF CORRECTIVE ACTION.

THIS DOES NOT MEAN THAT THE FEDERAL GOVERNMENT SHOULD REMAIN DORMANT ON THIS MATTER. THERE ARE SEVERAL AREAS WHICH ARE BEING

EXPLORED BY THIS AND OTHER COMMITTEES WHERE FEDERAL ACTION IS APPROPRIATE. ONE SUCH AREA INVOLVES POSSIBLE FEDERAL ANTI-TRUST VIOLATIONS.

WHILE THE PROPERTY/CASUALTY INSURANCE INDUSTRY IS GENERALLY EXEMPT FROM FEDERAL ANTI-TRUST LAWS, THERE ARE SEVERAL ACTIONABLE AVENUES OPEN TO US. AND IF AS SOME HAVE SUGGESTED, THE ENTIRE INSURANCE CRISIS IS PART OF A JOINT EFFORT BY BIG BUSINESS INTERESTS TO ACHIEVE CERTAIN STATUTORY REFORMS, THEN WE MAY NEED TO RE-THINK THE ANTITRUST EXEMPTIONS ALLOWED PROPERTY/CASUALTY INSURORS. I AM VERY INTERESTED IN HEARING WHAT OUR WITNESSES HAVE TO SAY ON THIS POINT.

INDEED, THE TESTIMONY WE HEAR TODAY AND TOMORROW WILL PLAY A CENTRAL ROLE IN THE ON-GOING DEBATE ON THE COST AND AVAILABILITY OF INSURANCE. IT WILL PROVIDE US WITH MUCH NEEDED INFORMATION IN OUR EFFORTS TO REDRESS THIS SITUATION. I KNOW THAT I WILL HAVE MORE TO SAY ON THIS ISSUE IN THE DAYS AHEAD AND AGAIN COMMEND OUR CHAIRMAN FOR MOVING FORWARD EXPEDITIOUSLY ON WHAT IS FAST BECOMING THE MOST PRESSING ISSUE IN OUR SMALL BUSINESS COMMUNITY.

Senator **Kasten**. Thank you, Senator.
Senator Gorton.

STATEMENT OF HON. SLADE GORTON, A U.S. SENATOR FROM THE STATE OF WASHINGTON

Senator **Gorton**. Mr. Chairman, Senator Sasser made a remark at the beginning of his statement which I felt was totally appropriate and I strongly suspect that this is the last time we will see Jim Sanders before this committee in his present capacity. I can say only that he will be grievously missed; that his stewardship of the Small Business Administration at a time of great difficulty, a great challenge to that administration, has been a credit to him, to the Small Business Administration, and a great service to the people. He should receive the highest commendation for that service.

Second, Mr. Chairman, on the subject of this hearing, it is absolutely clear in this connection that we are dealing with a real problem. From time to time all of us on this side of the table recognize that we have hearings on problems which are either minor or sometimes none existent. That is clearly not the case here. This is an important subject affecting a wide range of businesses, most particularly basic industrial manufacturing businesses in the United States, and gaining knowledge about the issue is greatly important.

I should also like to say that the chairman of this hearing, the Senator from Wisconsin, Mr. Kasten, has clearly been the leader in the Senate of the United States in attempting to solve the very real problems with which the country is faced.

As he knows only too well, we have not always agreed 100 percent on precisely what the solution is, but Senator Kasten has combined a willingness to accommodate to the ideas of others with a dedication toward solving the problem, which is a great credit to him and a real service to the United States. I certainly hope that in the course of this year he is successful in his quest.

Senator **Kasten**. Senator, thank you, and thank you very much for your comments, Slade.
Senator D'Amato.

STATEMENT OF HON. ALFONSE M. D'AMATO, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator **D'Amato**. Mr. Chairman, I'll ask that my statement be included in the record as if read in its entirety, but let me commend you for this hearing and for your work in this area, Mr. Chairman.

Indeed, this is more than a problem to some of our small businesses. In particular, it's a crisis; it's a crisis that has forced them in certain situations to terminate business. It's a crisis that many of our small municipalities face with the premiums just skyrocketing, and obviously those costs are then passed on to taxpayers.

It's a crisis when we see, for example, where these rates have no relationship, the premium increases, to the experiences in terms of claims or losses over a period of years, where in certain cases there have been absolutely no claims even filed, let alone losses; then someone finds his or her rates increased in some cases four- and fivefold.

Mr. Chairman, let me commend you for your work here in connection with these hearings.

[The prepared statement of Senator D'Amato follows:]

STATEMENT BY SENATOR ALFONSE D'AMATO
COMMITTEE ON SMALL BUSINESS
FEBRUARY 20, 1986   SR - 428A

MR. CHAIRMAN, I COMMEND YOU FOR HOLDING THIS IMPORTANT AND TIMELY HEARING ON THE COST AND AVAILABILITY OF LIABILITY INSURANCE. AS YOU KNOW, WE ARE ON THE BRINK OF AN INSURANCE CRISIS IN THE UNITED STATES, AND ITS IMPACT NOTABLY AFFECTS SMALL BUSINESSES.

INCREASINGLY, I AM HEARING FROM MY FELLOW NEW YORKERS ABOUT THE HIGHER PREMIUMS THEY ARE FORCED TO PAY FOR INSURANCE COVERAGE. RESTAURANTS, GROCERY STORES, AND ICE SKATING RINKS, ARE ONLY A FEW OF THE MANY BUSINESSES THAT HAVE HAD THEIR INSURANCE PREMIUMS INCREASED BY AS MUCH AS 400%. EVEN WORSE ARE THOSE BUSINESSES WHO ARE GOING "BARE", OR OPERATING WITHOUT INSURANCE COVERAGE, BECAUSE THEIR INSURANCE POLICY HAS BEEN CANCELLED, SOMETIMES IN MID-TERM! THE INSURANCE CRISIS IS ALSO IMPACTING UPON MUNICIPALITIES, SCHOOL BOARDS, AND CHILD CARE CENTERS.

INDICATIVE OF THE TIMLINESS OF THIS HEARING IS AN ARTICLE WHICH APPEARS IN TODAY'S NEW YORK TIMES ENTITLED "STATE STARTS STUDY OF INSURANCE CRISIS." IT MENTIONS THAT A MAJOR NEW YORK STATE LIABILITY INSURER CANCELED LIABILITY COVERAGE FOR 229 MUNICIPALITIES LAST YEAR, PARTLY DUE TO A 100% INCREASE IN THE NUMBER OF LAWSUITS FILED AGAINST PUBLIC OFFICIALS IN RECENT YEARS. THIS MUST END.

MR. CHAIRMAN, I AM VERY INTERESTED IN HEARING OUR WITNESS' TESTIMONY THIS MORNING. WE NEED TO EXAMINE CLOSELY THIS UNFORTUNATE SITUATION BDFORE IT BECOMES OUT OF HAND.

THANK YOU, MR. CHAIRMAN.

Senator **Kasten**. Thank you, Senator.

Our first witness is the Honorable James Sanders, the Administrator of the Small Business Administration.

I just want to echo the comments of a number of people that have spoken before me this morning. We thank you, Jim, for your work, for your service to the administration, but most importantly the work that you have done on behalf of small business. You've been a leader, been an advocate, been a strong partner that we on this committee have enjoyed working with, and I thank you for everything you've done, and you're going to be missed.

The Honorable Jim Sanders, the Administrator of the Small Business Administration.

Senator **Bumpers**. Mr. Chairman, before Mr. Sanders starts, may I insert a statement in the record on behalf of my colleague, Alan Dixon?

Senator **Kasten**. Without objection, so ordered.

[The prepared statement of Senator Dixon follows:]

Statement by Senator Alan Dixon

Senate Committee on Small Business

The Cost and Availability of Liability Insurance for Small Businesses

February 20 and 21, 1986

Mr. Chairman, the availability of affordable insurance coverage is an extremely serious and rapidly growing problem. The rising rates of insurance premiums have been widely publicized, and for some lines of business, increases of 300 percent, 500 percent and even more, have been reported.

Rising insurance costs have become especially burdensome to small business owners. Hundreds of small businesses from day-care centers to laundromat operators to accountants are reporting that they cannot afford or are having difficulty finding liability insurance.

Although small businesses cannot afford the higher insurance premiums, they cannot operate without insurance. It's sort of a "catch-22" situation for the segment of American industry that generates the majority of the new jobs in our nation.

Everyone is blaming everyone else for the liability insurance crisis. Hard pressed policyholders blame insurance companies; insurers blame their policyholders and lawsuit happy victims. The civil justice system has come under attack for reinterpreting insurance policy language to assure that every injury is compensated regardless of who is at fault, and for awarding sizable sums to victims. Attorneys have been criticized for their fees.

Mr. Chairman, I am pleased that the committee is investigating these issues. Our review can help shed some light on the causes of the liability problem and on their potential solutions I look forward to hearing from this morning's witnesses.

Senator **Kasten**. Mr. Sanders.

STATEMENT OF HON. JAMES C. SANDERS, ADMINISTRATOR, U.S. SMALL BUSINESS ADMINISTRATION

Mr. **Sanders**. Mr. Chairman, thank you. I'd like to thank all of you for those very complimentary remarks. I appreciate them very much, and I certainly reciprocate them. I have enjoyed serving this committee as the Administrator of the Small Business Administration, and I think we have together made some real progressive steps in improving the service to the public.

I have submitted my written statement for the record, and I would like to just make some extemporaneous comments.

I think some of you know that I come here not only as the Administrator of the SBA, but as an owner of a small business in California and also as an insurance person who spent his lifetime in the insurance business, and as a member of the Society of Charter Property Casualty Underwriters. I have some background in this activity and, as a matter of fact, have created insurance pools in my time.

I would like to make a few comments at the outset. First of all, I am impressed by the grasp of the issue that each one of you has demonstrated. Certainly you have examined this in depth. I think you understand the nature of the business—you have demonstrated that—and the underlying cause of so much of the problem which is our civil justice system.

I might say at the outset, Mr. Chairman, that we all recognize that this country of ours grew and prospered and was dynamic because the real wealth was produced by people who took risks, the entrepreneurs, the inventors, the Edisons of this country, the McCormicks, the Fords, the people who really stuck their necks out and took risks and created new ways to produce food and shelter and mechanical power and advantage. These were the people that truly set this Nation forth on a course that has exceeded all of the revolutions in the world in bringing wealth to the common man.

Now that is threatened under our free enterprise system because of a number of reasons. I would like to enumerate them.

I am concerned, maybe like Will Rogers, I would observe that, like the weather, everybody talks about it but nobody does anything about it. I know how hard Senator Kasten has worked to produce a product liability bill, and each year we become discouraged because it gets shot down or bottled up on one theory or another. In the meantime, the problem exacerbates, and the small business people of this country are the ones that suffer.

Insurance is an integral part of the risk-taking free enterprise system, and it is the investment of capital to assume risks of others with the expectation of a return for the assumed risk that drives the system. Even though this is perhaps the most effective way for an average business person or individual to transfer the risk to someone else, or at least take care of that risk, if there were no insurance at all, if all insurance companies disappeared, the problem of exposure to an expanding tort liability system would still be with us.

The problem surfaces now because the capital is too short at the present time in insurance underwriting to accommodate the expanding burden of American business from lawsuits of disastrous proportions. When the commercial lines rates were being cut—and, incidentally, I was active in the business when I would deliver umbrella premiums where the premium was sliced 50 percent one year and 50 percent again the next year—there were, of course, no complaints about the direction of those rates in those days, but there was an apprehension, as shared by everybody in the business, that this was going too far; that the cash flow underwriting was going to "become a cropper," and of course it has. The cyclical nature of the business is apparent.

But now that we have this situation, we can see in gross numbers, in aggregate numbers, that the total premiums written in commercial lines from 1978 to 1984, even though there were more risks being written, more people being insured, the total aggregate premium dropped by 20 percent, while the losses in that same period of time went to an all time high. So the premium income was going down in an aggregate number, and the total losses were increasing.

In that period of time the average medical malpractice jury verdict increased from $220,000 in 1975 to $1,017,000 in 1985. The average product liability jury verdict increased in 1975 from $393,000 to $1,850,000 in 1985, an increase of 470 percent.

There's also the problem of the excessive transaction cost of our civil justice system. According to the Institute for Civil Justice, in a justice litigation 63 cents of every dollar paid out by the manufacturers or their insurers is lost to attorneys 'fees and litigation expenses, and this does not include the cost of maintaining the court system.

It it has been said, and it could be well remarked, that litigation is the greatest growth industry in America. The risk transfer mechanisms, however, are working, and although not granting immediate relief for all small businesses who are threatened with extinction, we see every day new developments in pooling; in risk retention groups; in new forms that are being offered, although most of the new forms are more restrictive; in new excess and reinsurance combinations and companies being put together; and even the addressing of some more flexible regulations by State regulators.

But, of course, in the meantime small businesses, and indeed big businesses, and officers and directors and professional people, are being intimidated, are being driven out by this threat of lawsuit. How many businesses and jobs were never created because of this particular problem we'll never know.

We also know—and I know from my associates in London—that they will not play the game any more in America. They feel that they have lost all predictability for the civil justice system in the United States. They see courts reform contracts and put in coverage where there were exclusions on an almost whimsical basis, and they have other things to do with the capital.

We cannot coerce capital into this kind of a framework. It will just run away from us, and then we will have to look for alternative means.

I'm disappointed to see that in some States it's proposed that the State take over the entire system, and I then think we'd have a new entitlement program.

If the opportunity for profit was there today, you can believe that a significant number of the 3,500 property and casualty companies in this country would rush in.

Insurance cycles, like all business cycles, will always be with us. So we have to address the underlying machinery of the civil justice system to make some corrections. Otherwise, I believe a free society such as ours which depends on individual responsibility, a risk-and-reward system, a system that says those at fault should be the ones to carry the burden of the damages, that is in jeopardy.

Now I know of no reasonable person that's advocating abandoning the right to sue for damages or even the rights of lawyers to have contingency fees so that the person without funds can enter into a lawsuit to recover what he's justly entitled to. However, we should be reasonable and restore some kind of balance.

It was interesting when not so long ago in the Bhopal tragedy in India we saw the marvelous cartoon of the vultures with their briefcases hanging on the lines in India. It was only remarkable because it was out of character in India. Those vultures wouldn't seem so out of place in our own country. It's an American species.

If we don't take action here, you're going to see average Americans who have accumulated a lifetime of savings trying to find alternative ways to invest their capital outside the reach of the American civil justice system, so that through a whimsical lawsuit their entire life savings will not be threatened.

Finally, Mr Chairman, I would like to make a couple of specific recommendations which summarize the written report I have given you. I do think that in the States where the jurisdiction is present, they should examine the need for the abolition or the modification of the joint and several liability theory. There should be caps on noneconomic damages such as pain and suffering and punitive damages; the abolition of the collateral source rule and the consideration of sliding scales on attorneys' fees such as already has been passed in some States, particularly with medical malpractice in mind; periodic rather than lump sum damage payments; and alternatives to litigation such as binding arbitration especially for small claims. I'm encouraged by some prominent law firms that I know on the West Coast who are trying to move along quickly in alternatives to litigation for the resolution of claims.

There should also be pre-trial screening panels to detect and penalize parties who would bring frivolous suits. States should also consider repealing laws which restrict the ability of businesses to form insurance pools or to purchase insurance in groups. Those kinds of things are the immediate solutions to the pain and agony of today.

In the Federal role I would suggest that the Congress should reexamine the Superfund's strict retroactive and joint and several liability standards. I believe most of the money appropriated by Congress is going to end up in litigation costs and not cleaning up any of our polluted dumping sites.

Second, the Congress should continue to hammer out the details of Federal product liability laws, and I don't think we can afford any longer to be paralyzed by some archaic concept of States' rights when we have products that are shipped in a whole huge national market across all State lines.

Finally, the Congress should consider the need to preempt State laws that restrict the ability of businesses to form insurance pools or purchase insurance in groups.

Having said that, Mr. Chairman, I would be pleased to answer any questions.

[The prepared statement of Mr. Sanders follows:]

SBA

U.S. Small Business Administration
Washington, DC 20416

STATEMENT

JAMES C. SANDERS
ADMINISTRATOR

U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

"LIABILITY INSURANCE CRISIS"

FEBRUARY 20, 1986

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I APPRECIATE THE OPPORTUNITY TO COME BEFORE THIS COMMITTEE TODAY TO TESTIFY ON THE LIABILITY INSURANCE CRISIS WHICH IS PRESENTLY OCCURRING AROUND THE COUNTRY. THIS IS AN AREA IN WHICH I HAVE A DEEP PERSONAL INTEREST.

MR. CHAIRMAN, AN ALARMING NUMBER OF SMALL BUSINESSES ARE REPORTING DIFFICULTIES THEY ARE EXPERIENCING IN OBTAINING LIABILITY INSURANCE. WE ARE HEARING ABOUT THEIR INSURANCE PROBLEMS FROM SEVERAL DIFFERENT SOURCES. A NUMBER OF INQUIRIES HAVE BEEN RECEIVED BY THE SBA'S "ANSWER DESK," WHICH IS A TOLL FREE NUMBER OFFERING SMALL BUSINESSES INFORMATION AND ASSISTANCE.

THE CALLS TO THE ANSWER DESK ARE STARTING TO BECOME ALL TOO FAMILIAR. SMALL BUSINESSES ARE REPORTING PREMIUM INCREASES RANGING FROM 20 TO AS MUCH AS 1000 PERCENT. IN MANY CASES THESE PREMIUM DOLLARS ARE PURCHASING LESS PROTECTION, AS COVERAGE HAS

BEEN CUTBACK AND DEDUCTIBLES INCREASED. A NEW COMMERCIAL GENERAL LIABILITY (CGL) POLICY FORM BEING DEVELOPED TO INSURANCE SERVICES ORGANIZATION (ISO) WOULD ALSO INCLUDE CERTAIN LEGAL DEFENSE COST WITHIN THE POLICY'S COVERAGE LIMITS AND EXCLUDE COVERAGE FOR "SUDDEN AND ACCIDENTAL POLLUTION." FURTHERMORE, THE FORM PROVIDES COVERAGE ON A "CLAIMS MADE" BASIS INSTEAD OF THE BROADER "OCCURRENCE" BASIS WHICH WAS THE STANDARD UNTIL RECENTLY. IN ADDITION, THE NON-CONCURRENCE OF MATCHING CLAIMS-MADE EXCESS COVERAGE OVER PRIMARY OCCURRENCE COVERAGE PRODUCES DANGEROUS GAPS FOR THE INSURED.

IN ADDITION TO HIGHER PRICES AND CUTBACKS IN PROTECTION, A NUMBER OF SMALL BUSINESSES ARE REPORTING THAT THEIR POLICIES ARE BEING CANCELLED AND THAT COVERAGE IS NOT AVAILABLE AT ANY PRICE. THIS IS PARTICULARLY TRUE FOR MANY NEW BUSINESSES, VIRTUALLY ALL OF WHICH ARE SMALL.

SMALL BUSINESSES IN A BROAD CROSS-SECTION OF INDUSTRIES ARE KNOWN TO BE HAVING INSURANCE AVAILABILITY AND AFFORDABILITY PROBLEMS. THESE BUSINESSES INCLUDE MANUFACTURERS, DAY CARE PROVIDERS, MEDICAL AND OTHER PROFESSIONALS, TRUCKING AND BUS COMPANIES, ESTABLISHMENTS WITH LIQUOR LICENSES AND COMPANIES HAVING ANYTHING TO DO WITH CHEMICALS OR HAZARDOUS WASTE. THE INABILITY OF BUSINESSES TO OBTAIN POLICIES TO COVER ENVIRONMENTAL RISKS HAS REACHED CRISIS PROPORTIONS AND PROPOSED LEGISLATION FOR POLLUTION CLEANUP LIABILITY HAS ONLY EXACERBATED THE PROBLEM.

IN ADDITION TO THE NUMEROUS PHONE CALLS SBA IS RECEIVING, SMALL BUSINESS INSURANCE PROBLEMS HAVE SURFACED AS A PRIORITY ISSUE AT THE WHITE HOUSE CONFERENCES ON SMALL BUSINESS BEING HELD IN EACH OF THE 50 STATES. IN ALL BUT ONE OF THE CONFERENCES HELD TO DATE, LIABILITY INSURANCE AND PRODUCT LIABILITY PROBLEMS HAVE FORMED THE BASES FOR RECOMMENDATIONS FOR LEGISLATIVE RELIEF. THE MOST FREQUENT OF THE RECOMMENDATIONS FOR REFORM WAS SPECIFICALLY AIMED AT ACHIEVING A UNIFORM PRODUCT LIABILITY STANDARD. AS YOU

KNOW, MR. CHAIRMAN, THE CONGRESS HAS NOT, AS YET, PASSED FEDERAL PRODUCT LIABILITY LEGISLATION. BOTH THE ADMINISTRATION AND THE SBA HAVE CONSISTENTLY SUPPORTED EFFORTS TO DEVELOP NATIONAL PRODUCT LIABILITY STANDARDS. YET IN ALMOST 10 YEARS NO PROGRESS CAN BE REPORTED.

INSURANCE TECHNIQUES WERE USED BY THE EARLY PHOENICIAN SHIP OWNERS TO POOL CARGO LOSSES. THE MODERN PROPERTY-CASUALTY INSURANCE MARKET CAN TRACE ITS ROOTS BACK TO EDWARD LLOYD'S COFFEEHOUSE IN LONDON, WHERE IN THE 1680'S SHIP-HOLDERS GATHERED TO SHARE THE RISK OF A VESSEL BEING LOST AT SEA.

IN 1752, BENJAMIN FRANKLIN FORMED ONE OF THE FIRST FIRE INSURANCE COMPANIES IN AMERICA.

THEN, IN 1869 THE SUPREME COURT RULED THAT INSURANCE CONTRACTS DID NOT CONSTITUTE INTERSTATE COMMERCE AND WERE, THEREFORE, NOT SUBJECT TO FEDERAL CONTROL. INDIVIDUAL STATES WERE ALLOWED TO SET UP THEIR OWN REGULATORY BODIES TO PROTECT CONSUMERS.

IN 1944, THE SUPREME COURT RULED THAT INSURANCE WAS NOT "WHOLLY BEYOND THE REGULATORY POWER OF CONGRESS UNDER THE COMMERCE CLAUSE," AND, THEREFORE, WAS NOT EXEMPT FROM ANTITRUST LAWS. PRESIDENT FRANKLIN D. ROOSEVELT ASKED CONGRESS TO GIVE INSURANCE COMPANIES SEVERAL YEARS TO ADJUST TO THIS DECISION BUT INSTEAD CONGRESS IN 1945 PASSED THE McCARRAN-FERGUSON ACT (PL 79-15), WHICH GRANTED THE INSURANCE INDUSTRY A PERMANENT EXEMPTION FROM FEDERAL REGULATION AND ANTITRUST LAWS SO LONG AS IT WAS REGULATED BY THE STATES.

THAT ACT DID NOT BAR CONGRESS FROM ENACTING ANY LEGISLATION AFFECTING INSURANCE, AND IT HAS ACTED IN RESPONSE TO SPECIFIC PROBLEMS. IN 1968, FOR INSTANCE, IN ORDER TO ENHANCE THE REBUILDING OF RIOT-TORN CITIES, CONGRESS SET UP A FEDERAL RIOT INSURANCE PROGRAM THAT WAS EXPANDED IN 1975 TO PROVIDE CRIME INSURANCE FOR URBAN DWELLERS. (PL 90-448, PL 94-13). THE RIOT INSURANCE PROGRAM MADE MONEY BECAUSE DISTURBANCES DECLINED AFTER IT WAS INSTITUTED.

INSURANCE COVERAGE IS ALSO PROVIDED BY THE FEDERAL GOVERNMENT IN SOME AREAS THAT PRIVATE COMPANIES HAVE REFUSED TO TOUCH, SUCH AS: SWINE FLU VACCINATIONS, AGRICULTURAL CROPS, FLOOD-PRONE AREAS, PENSIONS, BANK AND SAVINGS AND LOAN ACCOUNTS.

IN THE MID 1970's CONGRESS HELD HEARINGS ON THE RISING COST AND SHORTAGE OF INSURANCE TO COVER MEDICAL MALPRACTICE HOWEVER, IT DID NOT LEGISLATE.

THEN IN 1981, IN ORDER TO MAKE IT EASIER FOR BUSINESSES TO OBTAIN INSURANCE AGAINST PRODUCT-LIABILITY CLAIMS, CONGRESS ENACTED THE "PRODUCT LIABILITY RISK RETENTION ACT" WHICH ALLOWED BUSINESSES NEEDING PRODUCT LIABILITY COVERAGE TO SET UP THEIR OWN INSURANCE POOLS OR TO PURCHASE INSURANCE POLICIES AS A GROUP. THIS LAW PREEMPTED STATE LAWS WHICH RESTRICTED SUCH ACTIONS. THERE ARE STILL STATE "ANTI-GROUP" LAWS, HOWEVER, THAT APPLY TO PURCHASERS OF OTHER TYPES OF LIABILITY INSURANCE.

1. THE IMPACT OF THE INSURANCE CRISIS ON SMALL BUSINESS AND THE ECONOMY

FIRST, I WOULD LIKE TO PUT MY STATEMENT IN CONTEXT BY DESCRIBING THE ROLE OF SMALL BUSINESS IN THE ECONOMY. BUSINESSES WITH LESS THAN 100 WORKERS EMPLOY APPROXIMATELY 44 PERCENT OF THE PRIVATE SECTOR WORK FORCE. IN RECENT YEARS, SMALL BUSINESSES HAVE CREATED MORE THAN TWO-THIRDS OF OUR NATION'S NEW JOBS. IN ADDITION, SMALL BUSINESS HAS PRODUCED 2.5 TIMES AS MANY INNOVATIONS AS LARGE BUSINESS, RELATIVE TO THE NUMBER OF PEOPLE EMPLOYED. THE ABILITY OF SMALL FIRMS TO CONTRIBUTE TO THE ECONOMY IS BEING CHALLENGED BY THE COST AND AVAILABILITY OF COMMERCIAL LIABILITY INSURANCE.

SMALL BUSINESSES ARE HIT PARTICULARLY HARD WHEN THERE ARE SHORTAGES OF LIABILITY INSURANCE. IT IS DIFFICULT FOR MANY SMALL BUSINESSES OPERATING IN COMPETITIVE ENVIRONMENTS TO PASS HIGHER

PREMIUM COSTS ON TO CONSUMERS. BECAUSE LIABILITY INSURANCE IS NOT A LUXURY ITEM BUT A NECESSARY EXPENSE OF DOING BUSINESS. SMALL BUSINESSES WILL HAVE TO FIND SOME MEANS OF PAYING FOR INSURANCE. IN MANY CASES. THIS MAY RESULT IN LIMITING BUSINESS EXPANSION AND REDUCING PAYROLL AND OTHER OPERATING EXPENSES. MOST SMALL BUSINESSES OPERATE ON VERY MODEST CASH FLOW AND DO NOT ENJOY THE FLEXIBILITY OF LARGE BUSINESSES TO DIP INTO PROFITS. RAISE PRICES. OR SHIFT COSTS AMONG VARIOUS LINES OF BUSINESS.

IN ADDITION. SMALL BUSINESSES MAY BE AT A DISADVANTAGE IN PURCHASING INSURANCE FROM CARRIERS. SMALL BUSINESSES PURCHASE LESS PROTECTION AND FEWER LINES OF INSURANCE THAN LARGE BUSINESSES AND MAY HAVE LESS LEVERAGE IN NEGOTIATING FAVORABLE INSURANCE RATES. SMALL BUSINESSES MAY ALSO HAVE DIFFICULTY OBTAINING FAVORABLE RATES BECAUSE MANY INSURERS DO NOT EXPERIENCE-RATE PREMIUMS FOR BUSINESSES UNDER A CERTAIN SIZE. BECAUSE IT IS DIFFICULT TO GENERALIZE SMALL FIRMS' EXPERIENCE.

INSURERS BASE RATES ON INDUSTRY-WIDE OR SUB-INDUSTRY CLASSES. THEREFORE, EVEN IF A SMALL FIRM CAN DEMONSTRATE A HEALTHY CLAIMS HISTORY, IT MAY NOT HELP THE FIRM TO ACHIEVE A MORE AFFORDABLE PREMIUM RATE.

AN ADDITIONAL FACTOR THAT PUTS SMALL BUSINESS AT A DISADVANTAGE IN BUYING INSURANCE IS ITS LACK OF IN-HOUSE EXPERTISE IN PURCHASING INSURANCE AND MANAGING RISK. IN MOST SMALL BUSINESSES THE BUSINESS OWNER MAKES INSURANCE DECISIONS ALONG WITH A HOST OF OTHERS, WHILE IN MOST LARGE BUSINESSES THERE ARE "RISK MANAGERS" ON STAFF, WHOSE SOLE DUTY IS TO PURCHASE INSURANCE AND ASSESS AND MANAGE RISK. RISK MANAGERS HELP TO DEVISE AND IMPLEMENT PROCEDURES TO IMPROVE SAFETY AND QUALITY CONTROL. FROM THE INSURER'S PERSPECTIVE, A BUSINESS IS A MORE ATTRACTIVE CUSTOMER IF IT CAN DEMONSTRATE THAT, TO SOME EXTENT, IT HAS ISOLATED AND REDUCED POTENTIAL RISKS.

IN ADDITION TO SMALL BUSINESSES' DIFFICULTIES IN PURCHASING COMMERCIAL INSURANCE POLICIES, SMALL BUSINESSES ARE LESS ABLE THAN LARGE BUSINESSES TO PROTECT THEMSELVES BY SELF-INSURING BUT MAY FIND A SOLUTION IN A GROUP INSURANCE POOL. THE LIMITATIONS OF INSURANCE ALTERNATIVES FOR SMALL BUSINESS ARE DISCUSSED IN MORE DETAIL IN SECTION 3.

MANY SMALL BUSINESSES THAT CANNOT OBTAIN COVERAGE AT ANY PRICE MAY SIMPLY GO OUT OF BUSINESS, PARTICULARLY THOSE BUSINESSES THAT ARE REQUIRED BY LAW TO CARRY INSURANCE. SOME SMALL BUSINESSES WILL CHOOSE TO "GO BARE" AND OPERATE WITHOUT INSURANCE COVERAGE, EXPOSING THE BUSINESS' AND, OFTEN, PERSONAL ASSETS TO POTENTIAL LIABILITY CLAIMS. FOR BUSINESSES OPERATING WITHOUT INSURANCE PROTECTION, IT WILL BE PARTICULARLY DIFFICULT TO OBTAIN FINANCING THROUGH COMMERCIAL LENDING INSTITUTIONS. TO AFFORD DRAMATICALLY INCREASED INSURANCE PRICES, SMALL BUSINESSES MAY DIVERT FUNDS FROM BUSINESS EXPANSION PLANS, PRODUCING A SIGNIFICANT LOSS TO THE ECONOMY OF JOBS, PRODUCTS, SERVICES AND INNOVATIONS. THIS

LOSS INCLUDES NOT ONLY THE NUMBER OF SMALL BUSINESSES THAT CONTRACT OR FAIL, BUT ALSO THE NUMBER OF FIRMS THAT NEVER START-UP BECAUSE OF THE COST OR UNAVAILABILITY OF INSURANCE.

2. CAUSES OF THE PROBLEM

THERE ARE SEVERAL REASONS THAT EXPERTS HAVE OFFERED FOR THE CURRENT PROBLEMS SMALL BUSINESSES ARE EXPERIENCING IN OBTAINING LIABILITY INSURANCE. ONE OF TWO MAJOR REASONS ADVANCED IS THE CYCLICAL NATURE OF THE INSURANCE INDUSTRY.

THE "UNDERWRITING CYCLE" APPARENTLY OCCURS AS INSURANCE CARRIERS PRICE THEIR POLICIES LOWER TO BUILD VOLUME AND THEN FINANCE LOSSES WITH INCOME FROM INVESTMENTS. WHEN THE INVESTMENT INCOME DECLINES AND WHEN CLAIMS OCCUR ABOVE ANTICIPATED LEVELS, RATES MUST BE INCREASED AND RISKS REASSESSED. FURTHERMORE, THE PRIMARY INSURER DOES NOT RETAIN THE FULL EXPOSURE OF THE LIMITS OF THE

POLICY, OFTEN "REINSURING" OR LAYING OFF AS MUCH AS 90% OF THE LIMITS TO OTHER INSURERS WHO SPECIALIZE IN REINSURANCE. IF THE RE-INSURERS ARE UNWILLING OR UNABLE TO CONTINUE TO WRITE THE INSURANCE, THE PRIMARY INSURER FREQUENTLY WITHDRAWS.

THE CAPACITY CONSTRAINTS OF THE INSURANCE INDUSTRY ARE RELATED TO THE INDUSTRY'S CYCLES AND CONTRIBUTE TO SHORTAGES OF LIABILITY INSURANCE. BECAUSE UNDERWRITING LOSSES ARE PARTIALLY PAID FROM "SURPLUS," WHICH IS THE EQUIVALENT OF A CORPORATION'S WORKING CAPITAL OR RETAINED EARNINGS, THE ABILITY OF AN INSURER TO WRITE POLICIES IS A FUNCTION OF ITS LEVEL OF SURPLUS. INTEREST RATES AND LOSSES DIRECTLY AFFECT SURPLUS LEVELS AND IN RECENT YEARS, HEAVY LOSSES AND DECLINING INTEREST RATES HAVE ERODED INSURERS' SURPLUS. THE RESULT IS A LACK OF CAPACITY TO SUPPLY BUSINESS CONSUMERS' DEMAND FOR INSURANCE PROTECTION.

IT SHOULD BE REMEMBERED THAT DURING THE PERIOD OF 1980 THROUGH 1983, INSURERS WERE SLASHING RATES BY AS MUCH AS FIFTY TO SEVENTY-FIVE PERCENT EACH YEAR - HOPING THAT THE INVESTMENT RETURNS WOULD COVER THE LOSSES.

TO ENSURE THAT CARRIERS DO NOT WRITE MORE BUSINESS THAN THEY CAN AFFORD TO WHEN SURPLUS IS LOW, STATE REGULATORS SCRUTINIZE INSURERS' PREMIUM INCOME RELATIVE TO THEIR SURPLUS. REGULATORS FOLLOW A RULE-OF-THUMB KNOW AS THE "KENNY FORMULA," WHICH THEORIZES THAT PREMIUMS SHOULD NOT EXCEED SURPLUS BY MORE THAN 2 TO 3 TIMES.

GIVEN THE CURRENT SHORTFALL IN INDUSTRY CAPACITY, INSURERS ARE RAISING PRICES, CUTTING BACK ON PROTECTION, TURNING AWAY NEW BUSINESS, AND CAREFULLY SELECTING THOSE BUSINESSES WHOSE POLICIES THEY WISH TO RETAIN. AS CAPACITY IS RESTORED, POLICIES SHOULD BECOME MORE READILY AVAILABLE AND INSURANCE PRICES SHOULD STABILIZE, IF NOT DECLINE.

KEEPING IN MIND THAT INSURANCE IS ONLY ONE WAY TO TRANSFER RISK (OTHER WAYS INCLUDE HOLD HARMLESS AGREEMENTS, LIABILITY WAIVERS, SELF-INSURANCE, POOLING AND ALL KINDS OF RISK MANAGEMENT TECHNIQUES), WE MUST EXAMINE THE MACHINERY THAT CREATES LIABILITIES AND ITS EXPANDING UNIVERST. THIS IS, IN SHORT, THE EXPLODING UNIVERSE OF THE CIVIL JUSTICE SYSTEM - THE TORT LIABILITY THEATER. IT WOULD APPEAR THAT LITIGATION IS AMERICA'S NUMBER ONE GROWTH INDUSTRY.

EACH STATE HAS ITS OWN STATUTORY AND JUDGE-MADE TORT LAW WHICH MAY VARY SIGNIFICANTLY FROM STATE TO STATE. THE DIFFERENCE IN STATE LAWS MAKES IT DIFFICULT TO PREDICT, FOR EXAMPLE, THE POTENTIAL LIABILITY OF MANUFACTURERS FOR DEFECTIVE PRODUCTS THAT MAY INJURE PERSONS IN SEVERAL STATES. INSURANCE CARRIERS ARE RELUCTANT TO UNDERWRITE LIABILITIES THAT THEY CANNOT ACCURATELY PREDICT. ADDITIONALLY, JUDGES AND JURIES ARE INCREASINGLY AWARDING DAMAGES TO AN EXPANDING GROUP OF PLAINTIFFS FOR HARMS THAT UNDERWRITERS NEVER INTENDED TO BE INCLUDED IN INSURANCE

POLICIES. PARTICULARLY IN THE AREAS OF ENVIRONMENTAL HAZARDS AND PRODUCT LIABILITY. AWARDS HAVE BEEN VERY SIGNIFICANT AND HAVE GONE TO UNANTICIPATED PLAINTIFFS FOR INJURIES NOT CONTEMPLATED BY INSURANCE CARRIERS.

WAS IT EVER THE THEORY THAT PUNITIVE DAMAGES SHOULD BE A WINDFALL FOR PLAINTIFF'S ATTRONEYS - I THINK NOT - BUT THAT IS WHERE IT HAS EVOLVED TODAY.

3. SOLUTIONS TO THE INSURANCE CRISIS

WHILE INSURERS' COMPETITIVE PRICING PRATICES CAN NOT BE DISMISSED AS A CAUSE OF THE CURRENT INSURANCE CRISIS. THE MOST EFFECTIVE MEANS OF RESOLVING THE CRISIS IS TO MAKE INSURANCE RISKS MORE PREDICTABLE. INCREASING REGULATION OF THE INSURANCE INDUSTRY WILL NOT RESULT IN REDUCING INSURANCE AVAILABILITY. RATHER. IT WILL CAUSE INSURERS TO MOVE CAPITAL TO LESS RESTRICTIVE MARKETS. ULTIMATELY RESULTING IN AN EVEN MORE GREATLY DIMINISHED INSURANCE

SUPPLY. CAPITOL IS ATTRACTED TO INSURANCE RISK-TAKING WHERE THERE IS A PREDICTABLE POSSIBILITY OF ADEQUATE RETURN FOR THE RISK.

TO BRING INSURERS BACK INTO THE MARKET PLACE, IT WILL BE NECESSARY FOR STATES TO ENACT REFORMS OF THE CIVIL JUSTICE SYSTEM. SOME OF THE REFORMS CURRENTLY UNDER CONSIDERATION BY STATES INCLUDE:

- MODIFICATION OF JOINT AND SEVERAL LIABILITY STANDARDS SO THAT LIABILITY IS ASSIGNED TO PARTIES ACCORDING TO THEIR RELATIVE RESPONSIBILITY FOR AN INJURY. THERE CURRENTLY IS A WIDESPREAD ADHERENCE TO THE "DEEP POCKET" THEORY - STICK IT TO THE ONE WHO HAS THE MONEY!

- LIMITATIONS ON NONECONOMIC DAMAGES, SUCH AS PUNITIVE DAMAGES AND DAMAGES FOR PAIN AND SUFFERING. SOME HAVE ADVOCATED A CAP OF $250,000 FOR NON-ECONOMIC DAMAGES.

- SLIDING SCALES ON ATTORNEYS' CONTINGENCY FEES. FOR EXAMPLE, AN ATTORNEY COULD RECEIVE 40 PERCENT OF THE FIRST $50,000 OF A DAMAGE AWARD; 33.3 PERCENT OF THE NEXT $50,000 AWARDED, 25 PERCENT ON THE NEXT $100,000 AND 10 PERCENT ABOVE $200,000.

- PERIODIC RATHER THAN LUMP-SUM PAYMENTS OF DAMAGE AWARDS. PROPONENTS URGE THAT STRUCTURED PAYMENTS OVER TIME WOULD LESSEN FINANCIAL HARDSHIPS ON INSUREDS AND INSURERS.

- ABOLITION OR MODIFICATION OF THE COLLATERAL SOURCE RULE. THIS RULE PREVENTS THE INTRODUCTION OF EVIDENCE IN COURT THAT A PARTY HAS BEEN COMPENSATED FOR AN INJURY FROM ANOTHER SOURCE SUCH AS SOCIAL SECURITY OR WORKERS' COMPENSATION. ABOLITION OR MODIFICATION OF THIS RULE WOULD RESULT IN REDUCTIONS IN DAMAGE AWARDS.

- USE OF ALTERNATIVE DISPUTE RESOLUTION MECHANISMS SUCH AS BINDING ARBITRATION. ALTERNATIVES TO TRADITIONAL LITIGATION, ESPECIALLY FOR RELATIVELY SMALL CLAIMS, WOULD REDUCE THE TIME AND COST OF CLAIMS ADJUDICATION.

- CREATION OF PRE-TRIAL SCREENING PANELS. SUCH PANELS WOULD DETERMINE THE VALIDITY OF SUITS AND PENALIZE PARTIES FOR BRINGING FRIVOLOUS SUITS.

FINALLY, THERE MAY BE INSURANCE AVAILABILITY PROBLEMS THAT RESULT FROM FEDERAL STATUTES, SUCH AS THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION AND LIABILITY ACT OF 1980 (CERCLA OR SUPERFUND). TO BRING INSURERS AND REINSURERS BACK INTO THE POLLUTION LIABILITY INSURANCE MARKET, IT MAY BE NECESSARY FOR THE CONGRESS TO CLARIFY OR AMEND THE LAW'S LIABILITY STANDARDS TO ENSURE THAT LIABILITY IS NOT IMPOSED ON A STRICT AND JOINT AND SEVERAL BASIS.

A DIFFICULT QUESTION IN RESOLVING THE VARIOUS LIABILITY INSURANCE ISSUES WILL BE DEFINING THE RESPECTIVE ROLES OF THE FEDERAL AND STATE GOVERNMENTS. BECAUSE, HISTORICALLY, STATES HAVE ENJOYED RESPONSIBILITY FOR REGULATING THE INSURANCE INDUSTRY AND ESTABLISHING TORT LIABILITY STANDARDS, IT WILL BE MOST EFFECTIVE FOR THE STATES TO RESOLVE INSURANCE PROBLEMS. BEYOND THE CLARIFICATION OF FEDERAL STATUTES, IT IS NOT CLEAR WHICH INSURANCE PROBLEMS THE FEDERAL GOVERNMENT MIGHT APPROPRIATELY ADDRESS. IN ADDITION TO AMENDING SUPERFUND, ONE POTENTIAL AREA OF FEDERAL INTERVENTION IS A NATIONAL PRODUCT LIABILITY STANDARD. FINALLY, THE FEDERAL GOVERNMENT MIGHT ENACT LEGISLATION PREEMPTING STATE LAWS THAT RESTRICT THE ABILITY OF BUSINESSES TO PURCHASE INSURANCE POLICIES IN GROUPS OR TO FORM INSURANCE POOLS.

I HOPE THAT THE WORK OF THIS COMMITTEE AND OTHER CONGRESSIONAL COMMITTEES LOOKING AT THE ISSUE WILL RESULT IN A DETERMINATION OF

THE PROPER ROLE OF THE FEDERAL GOVERNMENT IN RESOLVING INSURANCE PROBLEMS. HOWEVER, EXPERIENCE IN TRYING TO RESOLVE THE PRODUCT LIABILITY CRISIS AT THE FEDERAL LEVEL IS DISCOURAGING.

AT THE EXECUTIVE BRANCH LEVEL, THE ATTORNEY GENERAL HAS ESTABLISHED AN INTERAGENCY WORKING GROUP TO FOCUS ON A NUMBER OF TORT REFORM ISSUES, INCLUDING PRODUCT LIABILITY AND THE AVAILABILITY OF LIABILITY INSURANCE FOR BUSINESSES. THE SBA IS ASSISTING THE WORKING GROUP IN DEFINING SMALL BUSINESSES' INSURANCE PROBLEMS AND IN RECOMMENDING APPROPRIATE SOLUTIONS TO THE INSURANCE CRISIS.

IN THE SHORT-RUN, THERE ARE SOME PRACTICAL STEPS SMALL BUSINESSES WHO ARE HAVING DIFFICULTIES PURCHASING LIABILITY INSURANCE CAN TAKE. UNFORTUNATELY, FOR SOME NEW AND SMALL BUSINESSES, THERE MAY BE NO IMMEDIATE SOLUTION TO THE INSURANCE CRUNCH.

BUSINESSES SHOULD SHOP-AROUND FOR INSURANCE COVERAGE JUST AS THEY WOULD FOR ANY OTHER NECESSARY BUSINESS PRODUCT OR SERVICE. A NUMBER OF SMALL BUSINESSES THAT INITIALLY REPORTED POLICY CANCELLATIONS LATER INFORMED US THAT THEY WERE ABLE TO FIND SOME COVERAGE, ALTHOUGH SCALED-DOWN AND AT A HIGHER COST.

CONSUMERS SHOULD CONTACT STATE INSURANCE DEPARTMENTS TO SEE IF THERE IS A MARKET ASSISTANCE PLAN (MAP) OPERATING IN THE STATE. A MAP IS A VOLUNTARY ORGANIZATION OF INSURANCE CARRIERS WITHIN THE STATE WHICH ASSISTS BUSINESSES IN LOCATING DIFFICULT-TO-OBTAIN INSURANCE POLICIES. WHILE MAPs DO NOT GUARANTEE THAT A BUSINESS WILL OBTAIN COVERAGE, IN MANY INSTANCES, THEY MAY HELP A CONSUMER TO OBTAIN A SUITABLE INSURANCE POLICY.

SMALL BUSINESSES SHOULD DEVELOP RECORDS OF SAFETY PROCEDURES AND LOOK AT WAYS TO IMPROVE SAFETY AND QUALITY-CONTROL. IF POSSIBLE, SMALL BUSINESSES SHOULD FOLLOW THE LEAD OF LARGE FIRMS AND CALL IN RISK MANAGEMENT CONSULTANTS TO HELP ASCERTAIN RISK AND IMPROVE SAFETY PROCEDURES.

SMALL BUSINESSES SHOULD CAREFULLY EVALUATE THEIR INSURANCE NEEDS AND BE PREPARED TO ASSUME A GREATER AMOUNT OF RISK. THEY MAY BE ABLE TO NEGOTIATE BETTER POLICY TERMS IF THEY ACCEPT A HIGHER DEDUCTIBLE AND ASSUME LIABILITY FOR SPECIFIED RISKS OR EVENTS. FOR THOSE UNINSURED RISKS, IT IS VERY IMPORTANT FOR THE BUSINESS TO EVALUATE AND IMPROVE ITS SAFETY AND QUALITY CONTROL.

ANOTHER POSSIBILITY FOR SOME SMALL BUSINESSES IS TO OBTAIN A POLICY THROUGH A TRADE ASSOCIATION. SOME TRADE ASSOCIATIONS ARE ABLE TO NEGOTIATE POLICIES FOR THEIR MEMBERS THAT MAY OFFER LOWER RATES THAN THE BUSINESSES COULD INDIVIDUALLY OBTAIN. IF THIS IS POSSIBLE, THE AFFORDABILITY OR AVAILABILITY OF AN INSURANCE POLICY MAY WELL JUSTIFY THE PRICE OF MEMBERSHIP IN THE TRADE

GROUP. IT MAY ALSO BE POSSIBLE TO OBTAIN COVERAGE THROUGH THE TRADE ASSOCIATIONS MASTER OR GROUP POLICY, IF AVAILABLE. IN SEVERAL STATES, HOWEVER, THERE ARE LAWS THAT PROHIBIT OR RESTRICT THE ABILITY OF BUSINESSES TO PURCHASE INSURANCE IN GROUPS.

FOR SOME OF THE MORE PROFITABLE SMALL BUSINESSES, SELF-INSURANCE OR RISK-POOLING WITH OTHER BUSINESSES MAY BE A FEASIBLE ALTERNATIVE TO CONVENTIONAL POLICIES. A SELF-INSURANCE RESERVE REQUIRES A BUSINESS TO SET-ASIDE FUNDS TO COVER FUTURE CLAIMS.[1] A GROUP POOL, SUCH AS AN INSURANCE CAPTIVE OR MUTUAL COMPANY REQUIRES CAPITAL CONTRIBUTIONS TO ESTABLISH THE POOL, IN ADDITION TO ONGOING PREMIUM COSTS. FOR MANY SMALL BUSINESSES, HOWEVER, THE COST OF SELF-INSURING OR RISK-POOLING IS PROHIBITIVE.

IN ADDITION TO THE COSTS, ONE OF THE MAJOR PROBLEMS WITH SELF-INSURANCE AND RISK-POOLING IS THE DIFFICULTY OF OBTAINING

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[1] MONIES SET ASIDE FOR SELF-INSURANCE PURPOSES ARE NOT TAX DEDUCTIBLE; AMOUNTS ACTUALLY PAID OUT IN CLAIMS OUT OF RESERVES, HOWEVER, ARE DEDUCTIBLE. BUSINESSES CAN DEDUCT FROM INCOME PREMIUMS PAID ON A CONVENTIONAL INSURANCE POLICY.

NECESSARY REINSURANCE. WITHOUT REINSURANCE OR AN UMBRELLA POLICY, THE SELF-INSURED'S OR POOL'S RESERVES WILL MARK THE EXTENT OF ITS PROTECTION; THE BUSINESS' UNDERLYING ASSETS MAY BE USED TO SATISFY CLAIMS BEYOND THE EXTENT OF RESERVES.

SELF-INSURANCE AND INNOVATIVE GROUP-INSURANCE ALTERNATIVE WILL PROVIDE SOME BUSINESSES AND CITIES WITH NEEDED PROTECTION, WHILE PUTTING SOME COMPETITIVE PRESSURE ON CONVENTIONAL INSURANCE CARRIERS TO EASEUP ON PRICES AND AVAILABILITY. IT IS NOT CLEAR, HOWEVER, TO WHAT EXTENT SELF-INSURANCE AND INSURANCE CAPTIVES WILL PERSIST IN THE LONG-RUN AS COMPETITION IN THE CONVENTIONAL INSURANCE MARKET AS INCREASES AND PRICES BEGIN TO DECLINE. IN ADDITION, INCREASING LITIGATION AND DAMAGE AWARDS ARE AS MUCH A THREAT TO THE LONG TERM SOLVENCY OF ALTERNATE INSURANCE MECHANISMS AS THEY ARE TO STANDARD INSURANCE RATES.

THIS CONCLUDES MY PREPARED STATEMENT. I WILL BE HAPPY TO ANSWER ANY QUESTIONS YOU MAY HAVE.

Senator KASTEN. Mr. Sanders, thank you very much for your statement.

You said in your reference to London that we had lost all predictability. It seems to me there are two sets of problems here. One is the predictability or the pinpointing of the responsibility, the fault-finding, and the other set of problems is the fact that what we have got here is a patchwork of 50 different systems, and what may be predictable or at least understandable in one particular jurisdiction is absolutely different in another. The result is that you get to a system in which 63 cents—in your asbestos example, and they're all in that range—63 cents of every dollar is going to transaction costs or legal fees, not including the court.

Now in your view do we need a uniform product liability bill that will cover the entire country?

Mr. SANDERS. Well, I have believed for a long time, Senator, that we need a uniform product liability law that cuts across all the State boundaries, since every small manufacturer or business person never knows where his products are going to be sold or where he may be subjected to a suit. It seems apparent to me that that has to be uniformity throughout all of the States.

Senator KASTEN. You mentioned in your statement the Risk Retention Act of 1981, which preempted State laws and allowed businesses to form insurance pools or to purchase group policies for product liability coverage. Now how well has that law worked in your opinion for small businesses that need product liability coverage. The Risk Retention Act which some of us worked on in 1981—and then you pointed out that there still are some anti-group laws applying to other types of liability insurance.

Could you cite some examples and the effect that these statutes had? You said that you would like to have the Congress reconsider those, possibly to repeal some of these anti-group laws. Could you comment, first of all, on the risk insurance, the Risk Retention Act, and what that effect has had, and then specifically on some of these States with the anti-group laws?

Mr. SANDERS. Well, I don't have any precise numbers that I have seen that would indicate the increase in capacity that was created by the passage of that law. I'm quite sure from various stories I get that there have been number of these pools created for products liability.

As we both know, the problem there is it's limited to the products liability area, and there's just as much need in some other areas of liability for such pooling. That's what I referred to when I said that the States that do not have the enabling legislation to create joint underwriting authorities should do so.

When I was in California we created JUA's, Joint Underwriting Authorities, in which we would combine school districts, 10 or 15 school districts combined together, pooling their resources, and then it made the marketing of the excess liability of $10 or $20 or $50 million much easier as they retained in a pool the first level of liability exposure.

Those kinds of techniques are cried for at this particular time. I'd like to see that kind of approach in risk retention expanded to include liabilities beyond product liabilities. I think it's been very effective.

Senator **Kasten**. Senator Bumpers.

Senator **Bumpers**. Mr. Sanders, those figures you gave about the average jury verdict over the last 10 years are really staggering. Would you repeat those for me? I'm not sure I got them down right.

Mr. **Sanders**. You're talking about the medical malpractice and the——

Senator **Bumpers**. Yes. You said the medical malpractice jury verdicts had gone from an average of 200-and-something thousand in 1975?

Mr. **Sanders**. Two hundred and twenty thousand dollars in 1975 to $1,017,000 in 1985.

Senator **Bumpers**. And the next figure on——

Mr. **Sanders**. On products liability, jury verdicts, from $393,000 in 1975 to $1,850,000 in 1985.

Senator **Bumpers**. You're saying those are the average jury verdicts?

Mr. **Sanders**. Those are the average jury verdicts in those two areas.

Senator **Bumpers**. Where did you get those figures?

Mr. **Sanders**. These figures come from the Jury Verdict Research, Inc.

Senator **Bumpers**. Who is that?

Mr. **Sanders**. Well, they're a research group, and I can submit to you——

Senator **Bumpers**. Who funds that group?

Mr. **Sanders**. I don't know who funds the group.

Senator **Bumpers**. Where are they located?

Mr. **Sanders**. I picked this from a publication, and I would suspect that this group is one of those who does research on the basis of actuarial work for insurance companies.

Senator **Bumpers**. The reason that was so staggering to me—I don't believe that there have been half a dozen jury verdicts in the State of Arkansas in the last 10 years that exceeded $1 million product liability or malpractice.

Mr. **Sanders**. I would venture to say California would increase that number by 10 times.

Senator **Bumpers**. You believe in States' rights? You don't think that States' rights is archaic, do you?

Mr. **Sanders**. I do not think States' rights is archaic at all.

Senator **Bumpers**. Why should Arkansas be penalized because of California?

Mr. **Sanders**. Well, I think that capital will flow into the State where it's more comfortable for insurance companies to risk their capital on the basis of some return. It may be that Arkansas would be more conducive to that kind of a risk than California, but I do think that we have things in interstate commerce that should not be limited by the enormous variety in State law, and I believe certainly products is one of them.

Senator **Bumpers**. One of the problems I've always had with Senator Kasten's bill is I think it does intrude dramatically on the right of States to dictate tort law in their States, which has always been their prerogative. For 200 years we have reserved that right to the States, and for the U.S. Government to again into paternalistic posture of telling the States that they're not handling their business well and that we're going to take it over for them doesn't make much sense.

Seventeen States have already passed medical malpractice liability limits, and other States obviously will. Why is that not a suitable pattern to deal with that particular part of insurance instead of our sitting up here in Washington and saying that we're going to pass a bill that applies to all States?

Mr. SANDERS. Well, I must say that I am not optimistic that you will pass any law——

Senator BUMPERS. Well, I'm not, either. I think Senator Kasten's bill is dead, but I know that there is another bill that's coming along—no offense, Bob, but—there's another bill coming along, and it may be more acceptable. I don't know what Senator Kasten and Senator Danforth have in mind, but——

Mr. SANDERS. Senator, in answer to your question, I do believe that when you get into interstate commerce and talk about the national market that you find small business people exposed to the most unpredictable kinds of results in the variety of laws that apply to products liability suits throughout the 50 States. It seems to me that's a logical place to try a uniform law of exposure which will then encourage underwriting pools to come in and take that risk. Right now it's too capricious, and we can say all we want to about whether people ought to underwrite risks or not, but you know capital is only going to be attracted where it finds a comfortable environment.

Senator BUMPERS. Jim, are you concerned by the rather precipitous nature of these premium increases?

Mr. SANDERS. Oh, absolutely.

Senator BUMPERS. Doesn't it seem that the companies themselves could have taken a more judicious and responsible attitude by going through some kind of a transition toward higher rates, so that business could adjust to it?

Mr. SANDERS. Well, Senator, I would agree with you. It seems to be part of the cyclical nature of capitalism and our free economy. I don't think we've ever been able to totally correct that. When it was going on, and I was active in the business when the rate slashing and the cash flow underwriting began we all knew what was coming. We knew they would overdo it and they would come back in the other direction. But, as I say, nobody complained when the rates were being slashed by 50 percent.

Senator BUMPERS. But let me question you on that point, Jim. Wasn't a lot of the rate slashing going on then back when interest rates were 20 and 21 percent and they were taking premiums wherever they could get them in order to invest at those very high rates?

Mr. SANDERS. That's what cash flow underwriting is.

Senator BUMPERS. Yes.

Mr. SANDERS. Get the money in and invest it and hope for the best, and you hope that your losses don't exceed your income from outside investments.

Senator BUMPERS. There was a little greed involved there, wasn't there?

Mr. **Sanders**. There's a little greed involved in all these kinds of investments, Senator. I would wonder why some of the banks under——

Senator **Bumpers**. We all are; it just depends on whose ox is being gored. Incidentally, I understand that the advice on Wall Street, and has been for some time, to buy insurance.

Mr. **Sanders**. I think that there's no question that a number of the insurance stocks are going up. The brokers' stocks have certainly. They were depressed for a long time when the rates were being slashed.

Needless to say, as a representative of the brokering community, both here and having some investment in London, I suffer with a lot of my conferrers there who are trying to find placement for their clients and can't find it at adequate rates or affordable rates. Most of the creative ones are now being instrumental in creating joint underwriting pools, getting together with industries to pool their resources. These are things that probably are encouraged by the situation and should stay in place.

Incidentally, I think you also know that a few of the companies that were the most ambitious in creating rates are now bankrupt.

Senator **Bumpers**. Let me just make one last point, Mr. Chairman. That is that I am not totally opposed to all kinds of product liability limitations. It is a problem for small business in this country. It's a problem for big business, too, but especially for small business.

But I am a cosponsor of a bill, for example, that limits the liability for children who take a DPT shot. We know that 1 out of every 300,000 children who take a DPT shot—and that's the pertussis or whooping cough part of that—is going to have a profound reaction, severe mental retardation. That happens.

I am a cosponsor of a bill with Senator Hawkins to deal with that, but the way that we deal with that is to say that you can take two procedures. If you want to avoid a lot of attorneys' fees and lengthy litigation, then you can go through this arbitration process up to some amount, depending on the severity of the damage. But if you want to sue, if you want to go that route and try for more, that's your prerogative.

It seems to me that something of that nature might be in order in cases like this, but I think we should all bear in mind, when you start limiting liability to an arbitrary figure, you may think a million dollars is a tremendous verdict, but if you're parents of a child, for example, that's going to be in a wheelchair for 60 years profoundly retarded and institutionalized, and so on, $1 million doesn't seem like all that much money. It may seem like a lot today, too, but 10 years from now it may not seem like very much.

When you do that, Jim, you know who winds up with the burden of caring for those people, don't you, if they don't get a jury verdict suitable enough to take care of them and maybe a guardian appointed, and so on?

Mr. **Sanders**. Sure.

Senator **Bumpers**. Uncle Sugar.

Mr. **Sanders**. That's right. I wouldn't argue for a moment with that, Senator. I believe that the theory of fault and negligence should be firmly embedded in our system. I have only advocated the limiting of the awards for pain and suffering, not for economic recovery or economic damage. The cost of caring for someone who is permanently disabled for a lifetime is an economic damage, and I think that's perfectly justified. On the other hand, in the case you outline, how do you know which of the 300,000 children you inoculate is going to be the one that reacts? There's probably no way. There's no negligence involved in that.

Senator BUMPERS. No, there is not. Well, I won't pursue that any longer. The chairman has a long day here.

Senator KASTEN. Senator Harkin.

Senator HARKIN. I don't have any questions right now, Mr. Chairman.

Senator KASTEN. Let me just make one final comment because in the discussion that you just had with the Senator from Arkansas the whole issue of I think the crux of the compromise is about to be reached in an effort that I am making, with the help of Senator Danforth and others—consumer groups, labor groups, business groups, and others—to recognize the exact example that you used, where a person is injured and no one is at fault. Somehow we need to have a compensation system for that, a limited compensation system for that, and that we don't want to simply say that the person is injured; no one is at fault, but the theory of the law that's starting to develop is that someone has made a profit on that product; therefore, even though they weren't at fault, they should pay. That is an evolving kind of legal theory that's kind of an adjunct, if you will, to the deep pocket theory that's developed in some States.

What we're saying is that there is a legitimate problem here. Somehow we ought to deal with it. An accident has occurred and no one is at fault. This case, in fact, the accident has occurred and the product works for 1 of 300— whatever the number is. That's where we're going. We're trying to determine the issue, basically the outline of Senate bill 100 with uniform standards and predictability and fault finding, but then to add a limited compensation system that would deal with the problem of an accident that occurs when no one is at fault. That seems to be the direction that we're working in order to develop this compromise. Right now I'm optimistic.

Senator BUMPERS. Mr. Chairman, let me make one other statement before Mr. Sanders leaves. I'm going to check out this organization that gave you those average jury verdicts, because I don't believe that for a minute. I was a trial lawyer for 18 years and I have some feel for what's happened in my State and across the country. That would be a massive average. I know that hundreds of jury verdicts are rendered for less than $20,000 for every one that would exceed a million dollars.

That makes no sense to me, Jim. I know you're just quoting figures that somebody gave you; we all do.

Mr. SANDERS. I would encourage you to check this out, Senator, and I will follow up with you. But, of course, I must say that not many lawyers would enter into a lawsuit on a contingency basis where they only expected to get $20,000.

Senator BUMPERS. Are you kidding? I tried lawsuits for 18 years and 99 percent of them were less than $20,000. That was before 1970, but I'm telling you—[Laughter]—I've got two lawyers in my family right now that are practicing, and I guarantee you that they fall in the same category.

Mr. Sanders. That generally wouldn't cover the club bills for the lawyers in San Francisco. [Laughter.]

Senator Bumpers. Jim, you keep trying to put Arkansas and California together, and I resent that. [Laughter.]

Mr. Sanders. There's a big mountain range in between.

Senator Kasten. Mr. Sanders, thank you very much for your testimony. We appreciate your being here. Once more, we appreciate the work that you are doing and have done as the Administrator of the Small Business Administration. We thank you.

The next panel is Mr. Neely, Mr. Hess, Mr. Baldwin, and Mr. Simons. The first witness on this panel is Mr. Stan Neely who is the president of Trackmobile in LaGrange, GA.

Mr. Neely—and I might say if all if you can do as Mr. Sanders did, your entire statement will appear in the record as if read, but we would like to ask that you do as Mr. Sanders did, and that is to summarize your statement in roughly 5 minutes so that there will be time to hear from all the witnesses and also to reply to questions.

Mr. Stan Neely.

STATEMENT OF L.S. NEELY, PRESIDENT, TRACKMOBILE, INC., LaGRANGE, GA

Mr. Neely. Thank you, Mr. Chairman.

My name is Stan Neely. I'm president and CEO of Trackmobile, Incorporated, in LaGrange, GA. We're a management-owned company with roughly 50 employees. We do between $15 and $20 million a year in sales on an annual basis.

We produce mobile railcar movers, which is highly engineered, specific piece of capital equipment. We're the largest manufacturer of that piece in the world and originally developed it. We've got over 6,000 of those in operation throughout the world in every continent in the world.

Although we only employ 50 employees at Trackmobile, we buy between $10 and $15 million in goods and services, primarily in the United States, each year, and we estimate that that provides another 100 to 150 jobs at our vendors. We are a net exporter, and our balance of trade is between $2 and $3 million on the positive side every year.

We purchased this company last year from Signal Corp. At that time, during our first year of operation in 1985, for $10 million in product liability coverage our total premium was $122,500. We had basically not had been involved in a product liability claim and have not been since 1979.

We knew there was a product liability crisis brewing. Around mid-November of 1985 I got a call from my broker with some disturbing news. He said, "Stan, I think there's a possibility that your insurance is going to go up a little bit this year."

I said, "OK, well, send me the thing. We've got a good record." I wasn't too concerned about it. I was worried about other things.

Well, the insurance premium that we got was $831,000 to duplicate the coverage. Now it's apples-to-apples coverage; it's on a claims-made versus an occurrence basis, which I won't go into here, but it's a significantly different type of insurance.

That's a 678-percent increase for a company that basically has a good product liability record and has not had a claim or been involved in any kind of suit since 1979.

Our options under those circumstances were basically to sell the company to somebody else, a larger company who could roll the premiums up; raise our prices to cover the increased premiums; go without insurance altogether; sell our assets and lease them back to protect some of the assets in the event we did get in a product liability suit; or reduce our insurance coverage. A couple of the options that were not available to us because of our large market share are offshore captives and expensive reductions to match the premiums.

We chose to reduce our coverage as the only reasonable alternative, and what we ended up with is interesting. We've got 1 million dollars' worth of coverage now that has a quarter of a million dollar deductible for which I have to have a letter of credit in place from the insurance company, which reduces my working capital availability. My annual premium is $340,000 for 1 million dollars' worth of insurance.

We felt like that was the minimum acceptable for our size of company that we should keep. One major claim could ruin our company.

It was interesting to me, also, this year that a number of 30 insurance companies were asked to quote on our business. Only three chose to respond, and all three of the quotes were very, very similar in price. They were within 10 grand apiece.

In any event, our coverage also is on a sales basis. If our sales go up, our premium goes up proportionately. If it goes down, it goes down proportionately.

In summary, this will give you some idea of what impact this has had on Trackmobile. Again, we're a small manufacturer. We don't have many options. I believe, as Senator Bumpers does, in States' rights as much as anyone, but I do believe Federal intervention is required in specific instances in this particular problem. I've made my recommendations in writing. I won't go into them here because of the time constraints.

One small thing that I do think should be put in any law that's passed is the state-of-the-art limitation on manufacturers' liability. Our machines last 25 or 30 years. They go through numerous owners and are rebuilt five or six, seven different times. I think there should be some state-of-the-art limitation for a manufacturer's responsibility for machines that were built with current technology 25 years ago, and state-of-the-art technology at that time is dramatically changed over 25 years. We're just as responsible for the machines built in 1950 as the ones that were built yesterday—the same law, the same responsibility.

Thank you for the opportunity to let us express our views.

[The prepared statement of Mr. Neely follows:]

STATEMENT OF L.S. NEELY, PRESIDENT, TRACKMOBILE, INC., ON THE PRODUCT LIABILITY CRISIS, BEFORE THE SENATE SMALL BUSINESS COMMITTEE

FEBRUARY 20, 1986

TRACKMOBILE, INC., is a management owned company with 50 employees located in LaGrange, Georgia. Annual sales volume ranges between $15 million and $20 million.

TRACKMOBILE, INC., produces high-quality, mobile rail car movers which operate on the road and on rail. These units are primarily used for shunting rail cars and provide a low-cost, high-productivity option to locomotives. The company has sold over 6,000 units world-wide since 1950. The average useful life of a TRACKMOBILE is 25 years and TRACKMOBILES are in operation on every continent in the world. All other similar competitive units are basically copies of TRACKMOBILE'S weight-transfer design. TRACKMOBILE is widely accepted as the world's first and best mobile rail car mover.

Although TRACKMOBILE, INC., only employs 50 people at LaGrange, Georgia, we purchase between $10 million and $15 million annually in goods and services from vendors primarily located in the U.S. It is estimated that these purchases provide jobs for an additional 100 to 150 persons. We are a net exporter with a positive trade balance that ranges between $2 million and $3 million annually.

At the present time, TRACKMOBILE, INC., has no outstanding product liability suits. The last suit we were involved in was resolved in 1979.

The management group at TRACKMOBILE, INC., purchased the company from Signal Corporation (now Allied-Signal) in December of 1984. During our first full year in operation after the purchase, our product liability premiums and coverages were as follows:

BASIC COVERAGE	DEDUCTIBLE	ANNUAL PREMIUM
$500,000	$25,000 (per occurrence)	$87,500
UMBRELLA COVERAGE	DEDUCTIBLE	ANNUAL PREMIUM
$500,000 TO $10,000,000	N/A	$35,000
TOTAL		$122,500

Our normal insurance period runs from December 1 to November 30 of each year. In mid-November of 1985, we were advised by our insurance broker that we should expect a drastic increase in product liability insurance for 1986 policy year.

After numerous discussions with our broker and various insurance companies, the best premium quotes we received for retaining existing coverages were as follows:

BASIC COVERAGE	DEDUCTIBLE	ANNUAL PREMIUM
$1,000,000 (A)	$50,000	$663,300 (B)
UMBRELLA COVERAGE	**DEDUCTIBLE**	**ANNUAL PREMIUM**
$1,000,000 TO $10,000,000 (A)	N/A	$168,000 (B)
TOTAL		$831,300 (B)

(A) Claims made, not occurrence basis.
(B) Based on $15,000,000 sales.

NOTE: Although various other options were reviewed, including higher deductibles, claims made versus occurrence, no punitive damage coverage, etc., this quote represents the most similar coverage to the previous year. Of 30 insurance companies asked to quote, only 3 chose to respond. This premium represented an astounding 678% increase for a company that had no claims since 1979. This premium, if paid, would have exceeded our entire 1985 and expected 1986 after - tax earnings.

Our options under these most difficult circumstances were as follows:

(A) Sell the company to a larger company who could roll these premiums together with other operations.

(B) Raise our prices to cover the increased premiums.

(C) "Go Bare" with no insurance coverage and hope we did not have a claim.

(D) Sell our assets and lease back while "going bare" to protect against eventual suits.

(E) Reduce our insurance coverage.

Options that were not available to us included "off shore captive insurance companies" and expense reductions to match increased premiums.

We chose to reduce our insurance coverage and raise our deductible as we viewed this as the only reasonable and realistic alternative.

The coverage and premiums we retained for our fiscal year 1986 are as follows:

BASIC COVERAGE	DEDUCTIBLE	ANNUAL PREMIUM
$1,000,000	$250,000 (A)	$340,000 (B)
UMBRELLA None		
TOTAL		$340,000

(A) A letter of credit was required by the insurance company which reduces our working capital availability.

(B) Based on $15,000,000 annual sales.

This coverage was the maximum we felt we could afford under the circumstances. Even with these coverages, one major claim could put TRACKMOBILE, INC., out of business. As an additional result of these increases, we were required to postpone the formation of a new company, TRACKMOBILE Rail Switching Services, due to lack of availability of reasonably priced product liability insurance for these operations.

CONCLUSION AND SUMMARY

We feel that Federal Legislation is required because we find it highly unlikely that each of the States will pass consistent, uniform standards with regard to this issue. We further feel that any Federal Legislation should include the following key points:

- A simplified system that separates procedures for each plaintiff's recovery economic damages and recovery non-economic and punitive damages.
- Plaintiffs should have to pay manufacturers court costs and legal fees if any suit is found to be without merit or frivolous.
- Maximum limits for non-economic damages and punitive damages should be capped at realistic levels.
- A statute of limitations and "State of Art" limitations for manufacturers responsibility should be included in any reform.
- Attorneys contingency fees should be scaled.

Senator **Kasten**. Thank you very much.

Our next witness is Dr. Earl Hess, the president of Lancaster Laboratories, Lancaster, PA; also speaking on behalf of and representing the U.S. Chamber of Commerce in addition to his role as president of Lancaster Labs.

Dr. Hess.

STATEMENT OF DR. EARL H. HESS, PRESIDENT, LANCASTER LABORATORIES, INC., LANCASTER, PA; REPRESENTING THE U.S. CHAMBER OF COMMERCE

Dr. **Hess**. Thank you, Senator Kasten. As you indicated, I have a formal prepared statement to be entered into the record. What I will try to do in a few minutes' time here is to make some personal observations and comments.

My name is Earl Hess. I am founder, majority owner, and president of Lancaster Laboratories, which is an independent research and analytical laboratory located in Lancaster, PA.

I am pleased to have the opportunity to address this hearing not only as an individual small businessman concerned about the future of his own business, but also as a representative of several small business organizations.

My collective experience has given me a fairly broad appreciation of the terrible proportions of the current liability crisis. My official representation for this forum is in my role as chairman of the legislative policy committee of the U.S. Chamber's small business council. I should note that the strong emphasis which the chamber is putting on the liability crisis presently is something that originated in our legislative policy committee back in October 1985.

I won't soon forget that meeting in which small business persons coming from all over the country threw aside the agenda for the day and said, "We've got to talk about liability."

We're pleased that the chamber's board of directors has, indeed, picked up on that and is bringing a lot of visibility to this matter, as obviously you are through these hearings.

I'm in my second term as president of the American Council of Independent Laboratories, known as ACIL, which is a national trade association of mostly small testing laboratories such as my own in the chemical and engineering fields, providers of professional services, chemists or engineers "in private practice" if you will.

I'm immediate past chairman of the Lancaster Chamber of Commerce and Industry, which is the major business association in Lancaster County, PA.

Finally, I speak in behalf of the delegation from the State of Pennsylvania to the upcoming White House Conference on Small Business as its elected chairman.

As owner of my own small business, I'm deeply troubled with the current situation of unbridled, what I'll call, litigation pollution that could wipe out basically 25 years of blood, sweat, and tears poured into my company by myself and my wife, Anita.

I'd like to say that my fear goes beyond the financial risk that might be involved because I am a person who feels a sense of ownership and responsibility to employees, to clients, that have come to depend on my leadership of my small business.

We've enjoyed unprecedented growth in the past few years. We're currently completing our second major physical addition since 1980 and I've reached an employment level now of approximately 150 persons, half of which are degreed professionals in the technical fields.

Our company has grown, I think, mainly because it strives for excellence through careful hiring measures, state-of-the-art equipment and stringent quality control. But in today's litigious climate one suit could devastate my firm.

Of course, the difficulty with obtaining insurance is a main concern. I was covered until about 2 years ago on a private basis, adequately covered at what I considered a reasonable price. With no claim record whatsoever I was given 30 days' notice not that my premiums would go up, but that my insurance would be canceled.

Now I was very fortunate because our trade association [ACIL], had seen this thing coming and had done some very good homework. We now have a group insurance policy intact which at least gives me some protection, and the premiums are not extremely high.

On the other hand, the limits of liability are not nearly as high as I would like, and we see on the horizon now the introduction of exclusions for some of the work that we do which would essentially make us "go bare" in some of our most critical areas. One, for example, would be the work we do with respect to asbestos monitoring. When you say asbestos, everybody raises their eyebrows. It's possible that I may have to get out of that business, simply because of the liability problems, when I am really contributing, I think, to the solution of the asbestos problem.

I'd like to give you two horror stories, one from the experience of testing laboratories and another from my local experience in Lancaster County. Engineering testing firms doing construction materials engineerings, and so on, seem to be particularly suspectible to frivolous suits. In this particular case the firm was hired to inspect the concrete that would encase the girders for a bridge being built over a river. As the project was nearing completion, a workman on the bridge superstructure suffered loss of a leg in an accident caused by the break of a crane's cable. The worker sued the owners, the operators of the crane, the general contractor, the architects, and the testing laboratory, and every company connected with the project.

Remember, the crane wire is in the air and the concrete supports are 60 feet under water. Later investigation revealed that the problem was strictly a matter of a defective crane wire that had nothing to do with the testing lab. Nevertheless, it cost my colleague $30,000 in legal fees simply to defend himself, and it is still not certain that the court will offer a summary judgment. This is just one of a whole series of horror stories I could describe in my own industry.

I feel that I'm living on borrowed time and that, unless something is done seriously about tort reform, I will be in trouble.

I'd refer, then, finally to a local accounting firm. It has a 50-year history. It never was charged with a single liability claim, has a long history with a given insurance company, paying about $6,000 a year for a group of 38 people.

A year ago all of a sudden their insurance coverage was canceled, and they had to go on the open market. They are presently paying $33,000 a year, which is a 550-percent increase, while going across to a claims-made basis, losing most of their prior acts coverage, and really wondering whether they can stay in business or need to "go bare." Not only at the White House Conference in Hershey, but consistently across the States the top priority is the liability crisis. I'm having a problem right now as I try to place people on various committees to address issues, because about half my delegates want to be addressing the liability crisis when they come to Washington in the fall.

Mr. Chairman, "crisis" is an overused word, but it clearly applies to today's liability situation and its effect on small business. We strongly advocate civil justice reform as the fundamental solution, and I need to add that I think it has to be done on a Federal basis because there's no way that I can protect myself just within my own State.

The specifics of the effort include development of uniform standards of liability, so that those responsible pay for those damages; reformed damage rules, especially in the noneconomic loss and punitive damages areas.

We encourage the entire Congress to emulate the efforts of this committee and bring its energies to bear on seeking appropriate legislative solution.

Senator Kasten, I commend you and the Senate Small Business Committee for holding these hearings and thank you for affording me the opportunity to present my views. I'll be happy to answer any questions.

[The prepared statement of Dr. Hess follows:]

AVAILABLE

STATEMENT
on
THE LIABILITY CRISIS
before the
SENATE SMALL BUSINESS COMMITTEE
for the
U.S. CHAMBER OF COMMERCE
by
Dr. Earl Hess
February 20, 1986

I am Dr. Earl Hess, President of Lancaster Laboratories, Inc. in Lancaster, Pennsylvania. I am appearing on behalf of the U.S. Chamber of Commerce, the world's largest federation of business companies, chambers of commerce, and trade and professional associations. I serve as Chairman of the Legislative Policy Committee of the Council of Small Business, which is composed of small business leaders who recommend small business policy to the Chamber's Board of Directors. The Chamber appreciates this opportunity to present its views. It is a pleasure for me to be here.

Not long ago, I read a column in USA Today by Susan Percy of Atlanta. I would like to share a portion of that with you. I know of no better way to express the irony and frustration of today's topic than through this piece of satire.

Ms. Percy writes, "Now that lawsuiting has become a national pastime, here are some people I intend to sue:

"The Haagen-Dazs ice cream people, who make the chocolate-chocolate chip flavor. I'm suing to recover the $52.45 I paid recently for a black wool skirt. After consuming a quart of their ice cream, I discovered the skirt would not zip or button. Haagen-Dazs is clearly negligent; no warning of any such consequences appeared on the carton. I'm asking another $182.50 to cover the cost of the shoes, blouse and sweater that go with the skirt. And of course, $1.5 million for pain and suffering.

"The Atlanta Humane Society. I have adopted three different cats from these people, and each one of them has developed fleas. I'm pretty sure I see a pattern. I'm asking $4,000 for pest control services, veterinarians' fees and professional cleaning. Just $1 million for suffering, since this is a non-profit organization."

While these are humorous and exaggerated examples of our overly litigious society, these anecdotes emphasize a dangerous crisis that is threatening the economic well-being of our country. They underscore the fact that we are faced with a liability crisis in America.

The present crunch is causing severe hardships on businesses, professions, and municipal and local governments.

Many underlying causes have contributed to the present situation. Everyone is suing. Judges and juries appear to be overly generous to plaintiffs. Courts are broadening the legal doctrine of "strict liability," so that businesses, professional people, and their insurers may be made to pay for mishaps, even if the proof of fault is tenuous.

Although other factors may have contributed to the present situation, there is a concensus that the insurance crunch is merely a manifestation of a greater problem in our judicial system. The number of lawsuits in recent years has increased almost geometrically. Between 1978 and 1983, a record 12 million cases were filed. Most cases are filed in state courts. However, from 1940 to 1982, civil cases in federal courts increased sixfold, from 35,000 to 206,000. Federal product liability suits more than doubled from 1978 to 1984. In 1984, there was one private civil lawsuit for every 15 Americans.

As the number of cases filed has increased, the average dollar amount of settlements and awards has increased as well. In 1983, there were 360 personal injury cases with awards of $1 million or more -- this is 13 times as many as in 1975. The average product liability award has increased from $345,000 to over $1 million in the last 10 years, and the average medical malpractice award approached $950,000 last year.

Not only is the present tort system costly to producers and manufacturers, it is inefficient as well. Studies have shown that lawyers more often than not receive over half the dollars that are awarded to plaintiffs in these cases. A Rand Institute study has shown that in asbestos litigation, of the average $101,000 award or settlement, lawyers received $62,000.

Aside from the increasing costs of litigation, expanded tort doctrines have held defendant corporations liable for injuries that could not have been foreseen.

The doctrine of strict liability is expanding -- and industries are being held to higher standards of care than that of the "reasonable man." This is a result of the increased complexity of society and the belief that there should be financial redress for all injuries -- regardless of "reasonableness."

This notion of "compensation without fault" encourages actions against "unidentified defendants" and "deep pocket defendants" -- that is, businesses, utilities, and cities, and counties often become defendants in lawsuits, because they can afford to pay or have insurance rather than because they are at fault.

Overall, "fault" -- which historically has been the prerequisite to recovery of damages in the [illegible] system -- is no longer a prerequisite. More and more often, courts and juries have been permitted to speculate, how the redesign of a product or the use of a substitute material might have prevented harm or injury to a plaintiff. Unfortunately, such decisions often fail to take into account the ramifications of these decisions and to consider how this "second-guessing" poses potentially more serious threats to the consuming public.

The number of defenses against liability are waning -- being replaced by a concept of "absolute liability." The unexpected liabilities, as well as other losses, threaten the ability of insurance underwriters to provide the coverage needed in all lines of insurance. The insurance industry understandably is avoiding underwriting risks that it cannot identify.

As a result, liability insurance shortages are occurring everywhere -- from the highly publicized medical malpractice insurance of physicians, to the lack of liability coverage for municipalities, to the small business that is being forced to "go bare" or to go bankrupt.

Not only is there a shortage in the availability of liability insurance, but also there are significantly increased commercial and professional liability insurance rates, restrictions in coverage, and denials or cancellations of liability insurance.

In 1984 insurance companies paid $1.18 in losses for every $1.00 paid in insurance premiums. In 1984 property and casualty insurers had $21 billion in underwriting losses and $3.8 billion in net losses -- the first net losses since 1906, the year of the San Francisco earthquake. Net losses in 1985 were worse, an estimated 5.5 billion.

And not much hope is on the horizon -- indications now are that the demand for coverage in 1986 will exceed the insurance industry's capacity to provide coverage by $7 billion. The shortfall may go as high as $62 billion by 1987, according to some experts.

Present troubles also have been exacerbated by practices within the industry. Fierce competition in the late 1970s led to the issuance of imprudent policies at low premiums. When interest rates were high, premiums were invested. However, in 1984 interest rates collapsed, just as underwriting losses swelled.

Also, insurance regulators question liability insurance companies if they write additional business when the ratio of premiums written to policyholders' surplus may be inadequate, especially in the event of unexpected or catastrophic losses. This causes an insurer to abandon some clients to reserve its capacity for its better risks -- thus, an availability shortage is created.

Because of recent premium increases, more selective underwriting, and some coverage limitations, insurance companies are anticipating improvements. However, the market will remain very tight until fundamental and far-reaching changes are made.

In the short run, positive actions can be taken. The business owner can reassess his current insurance coverage -- considering higher deductibles, "going bare" in certain areas, and improving his risk management. The small business owner also can consolidate brokerage, maintain a good underwriter, or "shop around." In addition, he can consider buying insurance through a trade or professional association or by joining a cooperative.

Like Band-Aids, such stopgap efforts will give only temporary relief. For long-term relief, major surgery may be in order. Some states, such as Montana and California, already have placed caps on the amount of punitive damages that may be awarded for pain and suffering. Nine states, thus far, have enacted laws setting limits on awards in medical malpractice suits. Recently, the United States Supreme Court dismissed a challenge to a California state law that limits the fees lawyers may collect in medical malpractice cases. Similar measures should be considered by other states.

At the October 1985 meeting of the U.S. Chamber's Council of Small Business, the Council members recommended that the liability insurance developments merited the U.S. Chamber's attention. The members of the Council also believed that the civil court system was out of control and was a major contributing factor to the increased expense and decreased availability of liability insurance.

Their concerns were discussed at the November 1985 meeting of the U.S. Chamber's Board of Directors. The Board directed that a "Blue Ribbon Civil Justice Action Group" be formed to encourage changes in the civil justice system and that the Chamber use all its communication resources -- television, radio, and print media -- to publicize information about this situation. I have included at the end of my testimony (Exhibit 1) a complete list of activities that the Chamber has undertaken.

A special "Steering Committee," composed of a cross section of Chamber members, has met twice to provide guidance to and coordination of Chamber federation activities. Also, the "U.S. Chamber's National Clearinghouse on the Liability Crisis" was established in November to provide information to the business and professional communities on this issue. To date, we have received over 2000 telephone and mail requests for information packets.

Since November 1985, all of the Chamber's communication resources have been focused on the liability crisis. The cover story of Nation's Business in the February edition was on the crisis. The Business Advocate has published three stories. Washington Watch and Congressional Action have offered several articles. On BizNet, Nation's Business Today has provided feature coverage, and It's Your Business has produced two related programs.

On January 23, 1986, the U.S. Chamber sponsored six regional meetings in Los Angeles, Dallas, Denver, Atlanta, Chicago, and New York City to bring together all affected parties in an effort to hasten needed reforms in our civil justice system.

The Chamber also has been taking the message to Congress that the crisis is growing and that civil justice reform is extremely important. William Wyer, President of the Delaware Chamber of Commerce, testified before the Subcommittee on Business, Trade, and Tourism of the Senate Committee on Commerce, Science, and Transportation on December 3, 1985. On February 4, 1986, Frances Shaine, the Chairman of the Chamber's Council of Small Business, testified before the Subcommittee on Commerce, Transportation, and Tourism of the House Committee on Energy and Commerce.

The Chamber has undertaken a survey of its members to determine the impact of higher premiums for and in some cases lower coverage in their liability insurance policies. I am pleased to be able to share -- these survey results. I also should add that this survey is an ongoing process, and additional responses are anticipated, but we do not anticipate that the findings will change significantly. A copy of our survey is attached as Exhibit 2.

We have found that almost 83 percent of the businesses surveyed have been able to obtain or renew their liability coverage. Only 14 percent have been unable to renew or obtain needed coverage. Nearly three percent did not respond. Over 40 percent have had premium increases of between 100 to 500 percent, while nearly 10 percent had increases of over 500 percent. Because of these increases, 20 percent have had lower profits, and 17 percent have raised the price of their goods or services. General liability coverage presents the greatest problem (60%), followed closely by product (40%), officer and director (31%), and transportation (30%). Nearly 35% are considering going bare -- operating their businesses without any liability coverage at all.

Unfortunately, an incredible 95% believe that the problem will become worse. Only 14% have contacted their state insurance commissioner about their problems.

The survey continues by exploring opinions on the current state of the civil justice system. When asked why the number of liability suits and damage awards is increasing, 93 percent said the civil justice system encourages frivolous claims, while 84 percent believe that liability is based on the ability to pay, not on wrongdoing. Ninety-six percent believe that the size of awards is excessive in relation to the economic costs arising from injury, and 90 percent believe that the number and outcome of claims against their business are unpredictable.

The final question we asked is "(w)hich of the following approaches should the Chamber of Commerce pursue concerning this problem?" The answers were: 39 percent for civil justice reform; 63 percent for federal product liability legislation; 23 percent for tort reform; 42 percent for changes in insurance laws; and nearly 48 percent for all of the above. Interestingly, the last choice was "no action," and only one person checked that response.

These survey findings confirm in greater detail the recommendations from the state meetings preceding the White House Conference on Small Business. Two of the three leading recommendations concern this issue. The number one recommendation of the first 27 state meetings is tort reform, and product liability reform is the third leading recommendation.

We also must reemphasize the need to enact federal product liability legislation. With the present patchwork of laws, manufacturers and retailers are unable to comply with the conflicting standards that the states impose. One uniform federal product liability law would end our "lottery system of justice," in which a plaintiff may recover an enormous sum for damages in one state, while a similar claimant in another state receives no compensation. We must remedy a system that does not promote safety but instead redistributes enormous sums of money to attorneys who perpetuate this system.

Also, in the area of environmental liability, the federal government has expanded significantly its regulation of business activities for the purported purpose of environmental protection. However, these laws and regulations have effected protracted and costly litigation. For example, under current law, superfund liability is retroactive and open-ended.

Finally, the business community is showing an increasing interest in the medical professional liability problem. Escalating numbers of claims and inreases in the size of settlements and awards are raising health care costs and causing changes in the practice patterns of physicians. The changes ultimately affect society-at-large, as higher costs are passed on in the form of higher fees and health insurance premiums. The fact that medical professional liability problems are raising health care costs is even more significant in view of the intensive efforts in the public and private sectors to contain health care costs.

Employers are, of course, well aware of the impact of rising expenses of employee group health care plans on their costs of doing business and, thus, ultimately on their ability to compete. On the other hand, most employers may not be aware of the impact of medical professional liability on those health plan costs. In 1983, employers paid $65.3 billion in health insurance premiums for their employees. The impact of medical professional liability on these premiums, while difficult to measure precisely, is significant. Estimates of the impact range from $2 billion to higher than $14 billion. Thus, a significant percentage of the employers' health insurance premium may be attributable to "defensive medicine" (i.e., the ordering of additional tests and treatment procedures as a response to the increased risk of a professional liability claim) and increased professional liability insurance costs.

On June 12, 1985, the U.S. Chamber's Board of Directors adopted a statement on medical professional liability reform to assist the business community. For a complete copy of this statement, see Exhibit 3.

We must search for reforms sufficient to reverse the trend of increasing litigation and to solve the pressing liability problems that were not anticipated. On February 12, 1986, the Chamber's Board of Directors developed policy on civil justice and tort law reform, in recognition of the fact that the present civil justice system, including tort law, is in need of reform.

The Board stated that the civil law is intended to accomplish different goals. First, it is meant to provide incentives for reasonable behavior and disincentives to unreasonable behavior. Second, it is meant to provide redress to those who have been harmed by the unreasonable behavior of others.

In recent years, there has been an explosion of litigation, especially tort litigation, in the United States that threatens achievement of these objectives. Courts have consistently redefined substantive and procedural law to permit easier recovery of larger and larger amounts of damages, which often have little relationship to the economic loss suffered.

This has created a patchwork of inconsistent and often contradictory state laws. Contingent legal fees are a powerful incentive for initiating and continuing litigation. Costs associated with litigation have escalated. Litigation has, in fact, become America's equivalent of a national lottery. In such an environment, the predictability that is required for profitable business operations and rational insurance rate setting has vanished. As a consequence, liability insurance has become unaffordable or unavailable to many businesses.

There is an urgent need to reexamine the premises of the litigation system. The business community, its chambers of commerce, and its trade and professional associations must join together to restore rationality to the system so that it can operate more efficiently and fairly. Such a program of reform would, among other things:

- Develop uniform standards of liability that are consistent with the principle that those who are responsible for harm to the person or property of another should, to the extent of that responsibility, offset the harm they have done.
- Reform rules of damages, particularly as they relate to noneconomic loss and punitive damages.
- Reform rules of joint and several liability, contribution, and claim reduction.
- Provide for alternatives to lay determinations of complex medical, scientific, and technological issues.
- Develop fair and cost-effective alternative mechanisms to replace private litigation for dispute resolution.
- Reduce transaction costs by regulating contingent legal fees.

Also, alternative dispute resolution has become increasingly more popular. Nine states currently use arbitration for resolving disputes.

I have outlined certain broad areas in which civil justice reform is appropriate. Undoubtedly, if Congress and state legislatures would address these issues, there would be a positive effect on the ability of businesses to obtain insurance and/or obtain insurance at affordable rates.

This is not to imply, however, that other remedies should not be explored. We must depend on state regulations to guarantee that insurance policies are fair and to soften the harsh cyclical nature of the insurance underwriting business, without imposing undue burdens on the insurance industry. Similarly, we must make efforts to assist the underwriters in identifying groups that may be covered appropriately on a group basis. Finally, we must assist business in its time of great need to expand its search for insurance coverage at affordable rates.

Thank you for the consideration of our views -- I will be happy to respond to any questions.

EXHIBIT 1

U.S. CHAMBER ACTIVITIES TO DATE

- August 24th - "It's Your Business" program on the "crowded courts."
- September, 1985 - Nation's Business poll on "medical malpractice reform."
- October 3rd - Council of Small Business meets and recommends the formation of an "Emergency Task Force on the Liability Crisis."
- October 24th - "Emergency Task Force on the Liability Crisis" meets and makes recommendations to the Board of Directors.
- November, 1985 - "The U.S. Chamber's National Clearinghouse on the Liability Crisis" is created.
- November, 1985 - Business Advocate cover story on the "liability crisis."
- November 13th - Board of Directors recommends the establishment of a "Civil Justice Action Group" and "public awareness" campaign.
- November 15th - Association executives meet with Chamber staff to promote association participation in future activities.
- November 18th - "Nation's Business Today" features interviews with business executives.
- November 24th - "It's Your Business" program on "medical malpractice liability."
- November 26th - Chamber hosts an association briefing on the "liability crisis."
- December, 1985 - "Small Business Journal" television program features a commentary on the "liability crisis."
- December 1st - "It's Your Business" program on "product liability."
- December 3rd - Government and Regulatory Affairs Committee addresses the product liability issue.
- December 3rd - Chamber testifies before the Senate Commerce Subcommittee on Business, Trade and Tourism.
- December 16th - "Steering Committee on the Liability Crisis" holds its first meeting.
- December 17th - "Ask Washington" program on the "liability crisis."
- December 17th - Chamber hosts a Washington corporate representatives briefing on the "liability crisis."
- January, 1986 - Clearinghouse publishes its first monthly newsletter on the "liability crisis."
- January, 1986 - Combined meeting of Washington corporate and trade association representatives.
- January 23rd - Chamber regional conferences on the "liability crisis."
- January 28th - "Steering Committee on the Liability Crisis" holds its second meeting.
- February, 1986 - Nation's Business cover story on the "liability crisis."
- February 4th - Chamber testifies before the House Committee on Energy and Commerce Subcommittee on Commerce, Transportation, and Tourism on the "liability crisis."
- February 19th - Chamber testifies before the Senate Committee on Commerce, Science and Transportation on the "liability crisis."
- February 20th - Chamber testifies before the Senate Small Business Committee on the "liability crisis."

EXHIBIT 1
(page two)

PENDING U.S. CHAMBER ACTIVITIES

- February, 1986 - "Civil Justice Action Group" to be selected.
- February 21, 1986 - Chamber testifies before Senate Judiciary Committee
- April 30-May 1, 1986 - Chamber co-sponsorship of a "National Symposium on Civil Justice Issues," in cooperation with Fordham University Law School and the Insurance Information Institute.

EXHIBIT 2

The U.S.
Chamber's
National
Clearinghouse
on the
LIABILITY CRISIS

MEMBERSHIP SURVEY

(Responses to this survey will be used only in aggregate.)

1. What is your business or profession?______________________________

2. How many people do you employ? ______________________________

3. Have you you been able to renew/obtain the liability insurance you need?
   83.1% Yes 14.1% No

4. If yes have your premiums risen by?

   23.1% 10 - 50%
   17.5% 51 - 100%
   41.4% 101 - 500%
   9.9% More than 500%

5. What effect has this increase had, if any, on your business or profession? Lowered profit: 20.5%; Raised Prices: 16.7%; None: 5.2%

6. What types of liability coverage, if any, present problems to you? (Check all that apply.)

   60.3% General (Casualty)
   14.7% Environmental (including hazardous waste)
   13.2% Professional (Architects, Engineers, CPA's etc.)
   7.0% Medical Malpractice
   29.6% Transportation
   30.8% Officers and Direc
   40.7% Product
   10.4% Other (please spec

7. Do you see the problem, if any, getting better or worse for you?

   2.0% Better 95% Worse 3.5% (No response)

8. What alternatives if any are you pursuing? (Check all that apply.)

   24.2% Dropping products or services
   47.3% Paying higher premiums/raising prices accordingly
   3.3% Other (please specify)
   20.3% Self Insurance
   12.3% Closing your business
   35.5% Going Bare

9. Have you contacted your state insurance commissioner about this issue?
   14.5% Yes 48.2% No

10. In your opinion, why are the number of liability suits and damage awards increasing? (Check all that apply.)
    4.2% Professional and business communities are less competent
    93.2% The civil justice system encourages frivolous claims
    84.5% Liability is based on ability to pay, not wrongdoing
    60.0% Consumers have unrealistic expectations
    28.1% Other (please specify)

Exhibit 2
(page two)

11. In relation to economic costs arising from injury, the size of awards is:

0% too low   1.3% about right   96.0% excessive

12. The number and outcome of liability claims against your business or profession is:

8.2% predictable   90% unpredictable

13. Which of the following approaches, if any, to this liability problem should the U.S. Chamber of Commerce pursue? (Check all that apply.)

39.1% Civil justice reform
22.9% Tort reform

0% None

62.8% Federal product liability reform
42.1% Changes in insurance law
47.6% All of the Above
.8% Other (please specify)

NAME: ______________________________

COMPANY: ______________________________

ADDRESS: ______________________________

TELEPHONE: ______________________________

RETURN SURVEY TO: LIABILITY CRISIS PROJECT
BGP DEPT./U.S. CHAMBER OF COMMERCE
1615 H STREET, N.W./WASHINGTON, D.C. 20062

EXHIBIT 3

STATEMENT ON MEDICAL PROFESSIONAL LIABILITY REFORM
June 12, 1985

Why Should Business Have a Particular Interest in the Medical Professional Liability Problem?

Professional liability is no longer a problem facing just physicians and hospitals. Escalating numbers of claims and increases in the size of settlements and awards are pushing up health care costs and causing changes in the practice patterns of physicians. The changes ultimately affect society-at-large as higher costs are passed on in the form of higher fees and health insurance premiums. Equally important, access to some types of care, particularly complicated and high risk care, is restricted. The fact that medical professional liability problems are causing health care costs to rise is even more significant given the intensive efforts in the public and private sectors to contain health care costs.

Employers are, of course, well aware of the impact of rising expenses of employee group health care plans on their costs of doing business, and, thus, ultimately on their ability to compete. On the other hand, most employers may not be aware of the impact of medical professional liability on those health plan costs. In 1983, employers paid $65.3 billion in health insurance premiums for their employees. The impact of medical professional liability on these premiums, while difficult to measure precisely, is significant. Estimates of the impact range from $2 billion to as high as $14 billion or higher. Thus, a significant percentage of the employer's health insurance premium may be attributable to "defensive medicine" (i.e., the ordering of additional tests and treatment procedures as a response to the increased risk of a professional liability claim) and increased professional liablity insurance costs.

What Indications Are There Of An Increasing Professional Liability Problem?

Beginning in the early 1970's, there were sharp increases in the number and severity of professional liability actions filed against physicians, hospitals, and other providers of health care services. What followed in the mid-70's was a period of instability in the market for professional liability insurance. First, there were rapid premium increases and, next, a dramatic decrease in the number of commercial carriers offering professional liability coverage for physicians and hospitals. In an attempt to alleviate the "malpractice insurance crisis," a number of states enacted tort reform legislation and/or statutes designed to assure the availability of professional liability insurance (such as through creation of joint underwriting

EXHIBIT 3
(page two)

associations). In the meantime, many state medical societies created physicians-owned professional liability insurance companies, andbecame actively involved in risk management, medical disciplinary and educational efforts to minimize preventable incidents of negligence or "malpractice."

By the late 1970's, it appeared that these measures and others had been effective in resolving the problem of availability of professional liability insurance, as well as having some positive impact on the number and severity of claims filed. However, what was hoped to be a resolution to the problem now seems clearly to have been merely a temporary respite.

In the last several years, there have been sizeable increases in the number and magnitude of claims filed, which have resulted in medical liability insurance premiums going as high as $100,000 in certain metropolitan areas. There is also growing concern that increased medical liability exposure for high risk medical specialties is causing some specialists to limit or even withdraw from their practices, thus reducing access to care.

In the last five years, physicians have experienced increased risk of incurring a claim as well as greater losses per claim. In 1979, according to St. Paul Insurance Company, physicians incurred malpractice claims at an average annual rate of 3.3 claims per 100 physicians compared with 16.2 claims per 100 physicians in 1983. The severity of losses has also increased substantially.

There is no evidence that physicians or hospitals are more negligent in their delivery of health care today than in the past. In fact, one of the effects of increased "defensive medicine" may have been to decrease the numbers and/or magnitude of medical errors. On the other hand the tort system has allowed adjudication of cases increasingly on the basis of adverse results whether or not negligence was clearly demonstrable.

Guides For Business in Helping to Resolve the Professional Liability Problem

Because increasing professional liability insurance premiums and defensive medicine adds significantly to the overall cost of medical care, much of which is absorbed by businesses through increasing health care insurance premiums, business clearly has a vital stake in working toward a resolution of the problem. Since other sectors of the community, such as consumers, hospitals, physicians, unions, and the legal profession also have an interest in and a role to play in arriving at a fair and effective resolution of this problem, it may be that efforts to address the issue through health care coalitions will provide one very effective activity.

EXHIBIT 3
(page three)

As a guide to dealing with the professional liability problem, the Chamber offers the following principles:

1. Medical professional liability problems are a concern to business, since they add unnecessary costs to the health care premiums paid by both employers and employees and may reduce access to care.

2. Local health care coalitions and other community organizations should be encouraged to work toward resolving the professional liability problem in their areas as one important method of reducing health care costs.

3. Efforts to resolve the professional liability problem must ensure:

- speedy and efficient resolution of claims
- fair and adequate compensation for injuries arising from medical negligence
- a reasonable degree of protection from suits without merit so that access to care and costs of care are not negatively affected

4. Efforts to resolve the medical professional liability problem should include strengthened professional self-policing, risk management and peer review. Such efforts could be accomplished through public or private sector mandate and could include:

- reporting of settlements and awards to the state medical board and to hospitals

- establishing risk management programs in hospitals

- medical staffs reviewing and recommending action relating to medical liability awards or settlements involving a staff physician (with the hospital then reporting to the state medical board)
- encouraging hospitals to require and confirm information
- regarding the professional credentials and work history of physicians seeking staff privileges. Hospitals should keep records on current and former physician staff for purposes of reference checks and disciplinary proceedings.
- The tort system, as a deterrent to negligence and as a method of recourse after negligence, is beneficial to society and should be retained. However, reforms to the system are necessary to assure that it provides expeditious, fair and reasonable compensation for injuries resulting from negligence.
- Tort reform legislation should be enacted in the various states. One option which should be considered in order to encourage enactment of such state legislation is federal incentive legislation.

EXHIBIT 3
(page four)

Examples of basic tort reform measures include:

- **Limitation on Non-Economic Damages**

  Damages for pain and suffering and mental anguish are a primary cause of exaggerated professional liability awards because such damages are difficult to ascertain and are often influenced by emotion. The Rand Corporation estimates potential savings of 5-19% of medical liability litigation costs if non-economic damages are capped.

- **Structured Settlements and Awards**

  Providing structured settlements with periodic payments over an injured claimant's lifetime will ensure that the money will be there when needed and reduce the cost of the award.

- **Elimination of the Collateral Source Rule**

  There should be modification of the collateral source rule to prevent double payments.

- **Modification of Statutes of Limitation**

  The time period in which a patient has the right to file suit against a physician for an alleged injury should provide a reasonable balance between fairness to the plaintiff and fairness to the defendant. Many states still have statutes that permit suits to be filed so many years after evidence relating to the alleged negligence is known that appropriate defenses to claims are impossible.

For minors, the statute of limitations in many jurisdictions begins to run when a minor reaches the age of majority. Physicians who treat infants and children thus face potential liability for more than 18 years. The statute should provide a reasonable period to discover any injury and file a claim -- perhaps to age six or eight -- but not extend liability decades into the future.

Senator **Kasten**. Dr. Hess, we thank you.

Our next witness on this panel is Mr. Dana Baldwin, who is the president of Oliver Machinery Co. in Grand Rapids, MI, representing himself and also the Wood Machinery Manufacturers of America.

Mr. Baldwin.

STATEMENT OF M. DANA BALDWIN II, PRESIDENT, OLIVER MACHINERY CO., GRAND RAPIDS, MI

Mr. **Baldwin**. Thank you, Mr. Chairman.

I also will highlight my written testimony.

My name is M. Dana Baldwin II. I am president of the Oliver Machinery Co. of Grand Rapids, MI, and immediate past president of the Wood Machinery Manufacturers of America.

Oliver Machinery Co. is a moderate-sized woodworking machinery and metal sawing machinery manufacturer in Grand Rapids. We are starting our 96th year, having been formed in 1890. We currently employ 155 people. Our gross sales in 1985 were approximately $11 million, and for all practical purposes we broke even for the year.

WMMA is a trade association comprised of 113 different companies ranging in size from $300,000 or $500,000 annual volume up to a few companies with volumes in the $50 million-plus range. A few of these companies are parts of larger conglomerates, but the vast majority of the companies are relatively small operations, family owned, and, frankly, feeling very threatened.

While it is an honor to appear before this committee, it is both ironic and tragic that I should be here today. Ten years ago my father, Ralph Baldwin, whom I succeeded as president of Oliver, testified before this same committee on the problems faced by small businesses in obtaining product liability insurance. He sounded an early warning about the dire implications which the then-emerging liability crisis posed to this Nation.

In my opinion, if legislators had taken to heart what he had said and had acted upon it, we would not be faced today with a Damocletian sword hanging over the heads of this Nation's small businesses.

During the past few weeks I've been contacted by a number of small manufacturers that belong to WMMA. To a man, their stories contain the same elements: the extremely high cost of liability insurance without any recognition of experience ratings or lack of suits; the fear of bringing out new products because any change in technology can be used against you in a courtroom; the inability to expand volume because of the cost pressures brought on by the increasing premiums for less and less coverage; and the inability of older manufacturers to sell their companies because of their own inability to obtain ongoing assurances of coverage and the unwillingness of the investor to take on additional exposure that that represents.

During the past 11 years Oliver has spent $4.65 million to protect and defend ourselves against product liability claims. Included in that amount is the cost of insurance coverage, the cost of having a man full time on staff to defend against these suits, his expenses, the expenses of defense attorneys, expert witnesses, engineering services, and court costs.

During that time we had less than $1.1 million in judgments or settlements which we actually paid out. Of the $1.1 million, less than half ended up in the pockets of the injured parties.

From our own situation and those of other industry members, I know that the fear of adverse judgments and the extreme cost of product liability insurance discourage us from modernizing our plants and making equipment innovations. Consequently, we are severely inhibited and frustrated in our battle to remain competitive with foreign manufacturers who are not exposed to the exorbitant liability insurance cost burden that domestic manufacturers face. They have relatively few machines here, and thus do not have a long tail of exposure which my company does, having shipped almost 150,000 machines in our 96-year history.

The gravest and cruelest long-term effect of the liability crisis, however, is the impact which it will surely have on the innocent victims; namely, the millions of men and women who work for thousands of small U.S. manufacturers like Oliver.

Because of the cost pressures, because of competition, and because of the decreasing availability of adequate levels of protection through insurance, we owners are now being forced to significantly curtail our operations and may be forced eventually to abandon them.

Without expansion, we cannot add jobs. Without capital to modernize, we cannot add jobs. Without innovation, we cannot compete and, therefore, cannot add jobs.

Each of these factors builds upon itself and others to add up to the point where we cannot compete in the world market to supply the jobs and job security our people deserve and require.

Ten years ago my father made nine recommendations for solving the liability crisis. In my opinion, they continue to be the essential ingredients for bringing order to this ongoing chaos, and I will include them in the record. Some enlightened States have already enacted some of the provisions.

I would like to add a tenth to my father's list. Congress should outlaw lawyers from entering into contingency fee arrangements. A separate basis must be made for those people who cannot afford to sue, to protect them, but the contingency fee arrangement is a practice deemed unethical and is forbidden in England, France, West Germany, Norway, Sweden, Belgium, Switzerland, Italy, and four Canadian provinces including Ontario.

Finally, as a fourth generation president of Oliver Machinery Co., with a 13-year-old son waiting in the wings, and as a third member of the Baldwin family to serve as president of the WMMA, I would like to share these reflections with you:

It used to be true that the smaller companies in this country were the great innovators. This no longer seems to be the case. Product liability seems to have brought the small manufacturer to his knees. No longer at industry meetings do we hear much enthusiastic conversation about new developments. Now it's, "How are you coping?" or "What are you paying for insurance?"

It seems the very heart and soul of the best of our industry has surrendered itself to concentrating on defensive strategies. Even worse, it doesn't seem that the next generation is coming into the industry as has always been the case.

It almost seems as if the attitude is to let go, let the foreign concerns take over our industry; they don't have to worry about product liability. One company president told me recently he was unable to get insurance at any price; he was tired of spending all his time worrying about defending his excellent machinery in case after case and not having enough time to keep up with the current business. Resigned to his fate, he told me, "The next guy that sues me can have the business. Let him find out what it's like to run a machinery company. Maybe then he'll understand the headaches and heartaches he has caused me."

Let me add one more thought. The usual reaction is that the company has insurance; the insurance company will pay the judgment or the settlement. Well, some of us don't have any, and our so-called deep pockets are getting shallower and shallower.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Baldwin follows:]

STATEMENT OF M. DANA BALDWIN II, PRESIDENT,

OLIVER MACHINERY CO.

My name is M. Dana Baldwin II. I am president of the Oliver Machinery Company of Grand Rapids, Michigan and immediate past president of the Wood Machinery Manufacturers of America (WMMA). Oliver Machinery Company is a moderate sized wood working machinery and metal sawing machinery located in Grand Rapids. We are starting our 96th year, having been formed in 1890, and we currently employ 155 people. Our gross sales in 1985 were approximately 11 million, and for all practical purposes, we broke even for the year. WMMA is a trade association comprised of 113 different companies ranging in size from 300,000 to 400,000 annual volume up to a few companies with volumes in the 50 million plus range. A few of those companies are parts of larger comglomerates, but the vast majority of the companies are relatively small operations, family owned, and frankly, feeling very threatened.

While it is an honor to appear before this committee, it is indeed both ironic and tragic that I should be here today. Ten years ago, my father, Ralph Baldwin, whom I succeeded as president of Oliver Machinery Company and WMMA, testified before this same committee, then chaired by Senator Gaylord Nelson, about the problems faced by small business in obtaining product liability insurance. He sounded an early warning about the dire implications which the then emerging liability crisis posed to this nation. His crusade extended beyond Capitol Hill. He was instrumental in organizing the White House Conference on Product Liability held March 16, 1976. He traveled throughout the United States and Europe lecturing on the crisis. In 1977, he carried his message to the First World Congress on Product Liability Law in London, England, where he was the keynote speaker. In addition, he was the founder of the National Product Liability Council and member of the Department of Commerce Interagency Task Force on Product Liability.

In my opinion, if legislators had taken to heart what he had said and had acted upon it, we would not be faced today with a Damocletian sword hanging over the heads of this nation's small businesses. Unfortunately, his advice was not heeded and his predictions about the catastrophic consequences which were likely to befall this country's small manufacturers have proven eerily prophetic.

During the past few weeks, I have been contacted by a number of small manufacturers who belong to the WMMA. To a man their stories contain the same elements: the extremely high cost of liability insurance without any recognition of experience rating or lack of suits; the fear of bringing out new products because any change in technology can be used against the manufacturer in the courtroom; the inability to expand volume because of the cost pressures brought on by the escalating premiums which provide less and less coverage; the difficulty of older manufacturers in selling their companies because of their inability to obtain ongoing assurances of coverage and the unwillingness of prospective investors to take on the additional exposure and risks that this represents.

Skyrocketing Insurance Premiums: Disaster for the Woodworking Machinery Industry and Its Employees

Traditionally, a company in this industry is considered successful if it earns a net profit equal to 4 percent of its sales. This year, many WMMA have been forced to pay insurance premiums equal to 10 percent of their gross revenue.

How can a company hope to thrive when a machine which it sold decades ago for only $500 to $10,000 is now at the center of a $1 million lawsuit - despite the fact that the machine had operated safely for all those years. The $100,000 award which we recently paid in such a case plus the cost of preparing and defending the two lawsuits on a particular cut-off saw, are essentially equal to the after-tax profits made on the sales of all the cut-off saws made by Oliver in its 86 years of existence.

These outlandish settlements and judgments coupled with rapidly escalating insurance premiums are having a devestating impact on my firm and the entire woodworking machinery industry. The exorbitant insurance costs associated with bringing new products to market have forced us to curtail new machinery development. We have been hesitant to make substantial improvements in existing equipment fearing that the opportunity for plaintiff's attorneys to introduce these changes into evidence in a product liability action may be damaging to our defense. The budgetary drains caused by these premiums, defense costs, judgments and settlements, have caused us to curtail our capital investments in new machinery and equipment. Consequently, we are severely inhibited and frustrated in our battle to remain competitive with foreign manufacturers who are not exposed to the exhorbitant liability insurance cost burden that domestic manufacturers face.

Sadly, the gravest and cruelest long-term effect of the liability crisis is the impact that it will surely have on the innocent victims - namely, the millions of men and women who work for thousands of small U.S. manufacturers like Oliver. Because of the cost pressures, because of competition, and because of the decreasing availability of adequate levels of protection through insurance, we owners are now being forced to significantly curtail our operations and may be forced eventually to abandon them. Without expansion we cannot add jobs. Without capital to modernize we cannot add jobs. Without innovation, we cannot compete effectively in a world market to supply the jobs and job security that our people deserve and require.

Are Congress and the various state legislatures prepared to allow thousands of small manufacturers to be driven out of business? Are they prepared to watch thousands of American factory workers lose their jobs and their dependants suffer? Today, the tort system as it relates to product liability claims is an irrational, haphazard, chaotic compensation system which only enriches trial lawyers at the expense of business, consumers and victims. The experiences related to me by current and, too often, former WMMA members clearly demonstrate that it is no exaggeration to state that the existing tort system is destroying this industry.

Product Liability: Examining the Costs

To provide the Committee with a more in-depth understanding about the cost posed to small manufacturers by product liability concerns, I have set forth a detailed accounting of the cost incurred by Oliver Machinery Company. During the past 11 years, Oliver has spent $4.65 million to protect and defend itself against product liability claims. Included in that amount is the cost of insurance coverage, the cost of having a man full time on staff to investigate and defend against these suits, his expenses, the expenses of defense attorneys, expert witnesses, engineering services and court costs. During that time we had less than $1.1 million in judgments or settlements which we actually paid out.

Between January 1, 1975 and August 1, 1978, we were insured with a retrospective premium policy by one of the nation's largest insurance carriers. During that three-and-one-half-year period, they paid out almost $700,000 in judgements and settlements. Since August 1, 1978, we have essentially been self-insured through an extremely large self-retention layer, $200,000 per incident, with underlying umbrella and insurance coverage above those levels to insure against a catastrophe. During this time period we have paid out less than $400,000 in judgments and settlements. In twice the time period, we have paid out just over half the amount the insurance company paid out during its three and one half year tenure. This inevitably leads to the conclusion that the insurance companies are not willing to take a stand as we have and fight each claim to the end. As the figures reveal below, we have paid out a tremendous amount in expert witness fees, defense attorneys fees and so on, but we feel in the long run we will be better off and have lower total costs by doing this.

The insurance companies have taken the opposite point of view, trying to minimize their exposure in any given case rather than looking at the overall long-term picture. For instance, one WMMA member's complaint about his insurance problem centered on the fact that the insuror was willing to settle a claim in which an individual lost parts of two fingers in a cut-off saw that did not malfunction, but in which the worker carelessly stuck his fingers into the operating zone and initiated the cutting cycle. The individual was not satisfied with the money he received through Worker's Compensation and brought a product liability suit alleging the saw was defective. Ignoring the WMMA members strenuous protest that the injury was caused by the workers carelessness and not a machine defect, the insurance company settled for $200,000. Even though the WMMA member was obliged to pay his $50,000 deductible, he had no say in deciding the settlement amount or deciding whether or not to litigate the claim. The insurance company was simply going to minimize its exposure and in all probability pass on the cost in the form of a higher premium the following year, or cut him off.

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Statistical Information on Costs to the Oliver Machinery Company Directly Related to Insurance Premiums and Payments Made to Plaintiffs, 1975 though 1986.

Insurance Year			
1/1/75 to 1/1/76	Retrospective Premium	$ 75,363	
	Administrator wages	36,400	
	Cost of discovery	6,800	
		118,563	$118,563
1/1/76 to 1/1/77	Retrospective Premium	$273,685	
	Administrator wages	36,400	
	Cost of discovery	6,900	
		316,985	$316,985
1/1/77 to 1/1/78	Retrospective Premium	$457,048	
	Administrator wages	39,000	
	Cost of discovery	6,900	
		502,948	$502,948
1/1/78 to 8/1/78	Retrospective Premium	$566,470	
	Administrator wages	23,160	
	Cost of discovery	5,250	
		594,880	$594,880

From 8/1/78 through 8/1/85 we were self-insured at $200,000 per person, $500,000 annual aggregate 300/500,000 excess plus umbrella up to $10,000,000.

8/1/78 to 8/1/79	Insurance Premium	$230,775	
	ESIS service	4,600	
	Administrator wages	40,300	
	Cost of discovery	7,200	
		282,875	$282,875
8/1/79 to 8/1/80	Insurance Premium	$230,500	
	ESIS service	5,490	
	Administrator wages	42,900	
	Cost of discovery	7,300	

		286,190	$286,190
8/1/80 to 8/1/81	Insurance Premium	$190,520	
	ESIS service	7,250	
	Administrator wages	42,900	
	Cost of discovery	7,400	
		248,070	$248,070
8/1/81 to 8/1/82	Insurance Premium	$148,470	
	ESIS service	6,513	
	Administrator wages	36,400	
	Cost of discovery	7,400	
		198,783	$198,783
8/1/82 to 8/1/83	Insurance Premium	$ 39,200	
	ESIS service	4,277	
	Administrator wages	37,700	
	Cost of discovery	7,400	
		88,777	$ 88,777
8/1/83 to 8/1/84	Insurance Premium	$ 44,200	
	ESIS service	4,277	
	Administrator wages	37,700	
	Cost of discovery	7,800	
		93,977	$ 93,977
8/1/84 to 8/1/85	Insurance Premium	$ 74,000	
	ESIS service	2,730	
	Administrator wages	39,300	
	Cost of discovery	8,100	
		124,130	$124,130
8/1/85 to 8/1/86 Self-insured $200,000 per occurrence, $800,000 annual aggregate plus $1,000,000 excess.			
	Insurance Premium	$288,634	
	ESIS service	2,865	
	Administrator wages	39,000	

Cost of discovery	8,200	
	338,699	$338,699
	Total	$3,194,877

The above figure of $3,194,877 represents the amount of money that the Oliver Machinery Company paid, or will have paid from January 1, 1975, when the product liability problem began to be really serious, through August 1, 1986. This amount covers all insurance premiums, the salary and fringes for our in-house product liability expert plus the cost to Oliver of travelling to the sites of accidents and the studies of why and how the accidents occurred. It also covers the service charges of ESIS during the time we were largely self insured. It does not include any expenses that top management incurred during this period nor any of the costs my father incurred during the years he was actively travelling and working on product liability matters. It does not include the settlements, judgements and related costs during the period we were self insured.

For the period January 1, 1975 through August 31, 1981, we paid $1,372,566 for retrospective insurance. Total costs, including insurance premiums and defense costs, were $1,533,376. During this time, we had judgments and settlements of $688,887. This figure equals 50.1% of the insurance cost and 44.9% of the total cost.

During the period of 8/1/78 to 12/21/85, we were partially self-insured and could generally make our own decisions on whether to settle or go to trial. We had judgments and settlements during that period of $395,343. In this same period, our total defense costs including judgments and settlements were:

For closed claims and associated costs	$1,251,335
For open claims and associated costs	200,152
	$1,451,487

The judgments and settlements in this period were 40.1% of the insurance premiums and 27.2% of the $1,451,487 total cost.

In addition, we have outstanding reserves for this period of $754,721. Including the reserves, our total cost attributable to product liability suits from January 1, 1975 through December 21, 1985 (with certain additional costs to August 1, 1986) has been $5,401,085. If the reserves are not included, the minimum out of pocket costs for this period come to $4,646,364.

The total dollar value of judgments and settlements in the eleven plus years was $1,084,230, which is 23.33% of the minimum total cost to Oliver.

Product Liability: The Trial Lawyers' Money Tree

It must be pointed out that the minimum contingent fee charged by an attorney to a plaintiff usually is 33.3% and there are almost always additional expenses such as repayment of Worker's Compensation. It is very doubtful if the plaintiff receives over 55% of a settlement or judgment. This means that over this eleven-plus year period, plaintiffs who sued Oliver received only 23.33% times 0.55, or 12.83% of the total cost to Oliver for the suits. The cost to Oliver was 779% of the amount received by the plaintiffs.

I probably am too conservative in estimating the take of plaintiff's attorneys. Quoting the *Wall Street Journal* of February 3, 1986:

> "Plaintiff lawyers get rich practicing a form of greenmail on defendants - they threaten that if there is no settlement, the defendant will spend millions on lawyers. If there is a trial, juries sometimes take pity on a suffering plaintiff and are glad to be able to award damages even if there was no fault. Rand Corp.'s Institute for Civil Justice estimates that when contingency-fee cases are won, two-thirds of the damage award goes to lawyers and only one-third goes to the plaintiffs. The large class-action suits give nickels and dimes to the injured, but make millionaires of the lawyers. So the incentive for the plaintiff's bar is to pick the most widely used products and most sympathetic injured clients."

If the Rand estimate of 35% is used instead of the 55% estimate which I used above for Oliver Machinery Company cases, the plaintiffs would receive not more than 8.16% of the amount of money spent by Oliver in fighting the product liability battle. The actual cost to Oliver would then be 1225% of the money actually received by plaintiffs.

I do not dare to estimate what the amount of money taken from the American economy by trial lawyers, both plaintiff and defense, but it is huge and exceeds that retained by plaintiffs many times over. The *Wall Street Journal* of January 21, 1986 stated: "Settling liability claims in and out of court cost more than $70 billion last year." Suffice it to say that attorneys, both plaintiff and defense, claimed well over $35 billion of this bounty.

Product-Related Injuries: Who Is to Blame?

With few exceptions, woodworking and metalworking machines are not defectively designed. Great efforts have been made to make them as safe as possible. The fact of the matter is, however, that these machines are inherently dangerous products. The dangers associated with the products' use are apperent to its operator - or in legalistic terms, open and obvious.

While accidents do occur, our experience has revealed that virtually every one is caused by the carelessness of the operator, or the failure of the employer to perform routine maintenance on the product and unauthorized removal of the safety features of the machine. The National Safety Council has estimated that approximately 85% of work injuries involve an unsafe act such as negligence, failure to use safety equipment, operating at unsafe speeds, etc. We pose the question of whether a machine should be considered defective if an individual loses some fingers because he pushed his hand under the saw guard or into the saw blade while feeding wood. Similarly, would the same machine be defective if the operator or his employer removed the guard over the saw blade and the operator were subsequently injured? WMMA would answer the question with a resounding "no"!

The Oliver Machinery Company has manufactured and sold about a 150,000 machines since 1890. We receive notice of about nine accidents per year, mostly in the woodworking and metal sawing machinery lines. In most of these cases, Oliver receives a summary judgment or the case is settled for a nominal amount, but our expenses are nevertheless substantial.

We have always endeavored to build machinery of the highest quality and our safety features, guards, etc. have always met or exceeded the standards in effect at the time of manufacture. Many of the old guards meet or exceed present day OSHA and ANSI standards. In spite of major engineering efforts we do not know how to build safer machines. Neither does anyone else.

Recommendations for Solving the Product-Liability Crisis

Ten years ago, my father made nine recommendations for solving the liability crisis. In my opinion, they continue to be the essential ingredients for bringing order to this ongoing chaos. A number of enlightened state legislators have already enacted similar provisions. We think that it is time for Congress to do the same for the entire nation.

1. There must be a reasonable statute of repose. A product which has performed normally in the field for a reasonable length of time should be exempt from product liability suits. We recommend a period of six years.

2. Liability should be based on the state of art at the time of manufacture rather than expecting an antique product to meet modern safety requirements. This would require that the design, manufacturing and testing of the product be done in conformity with generally recognized and prevailing standards in existence at the time of manufacture. Evidence of subsequent advancements or changes in knowledge or techniques should be made inadmissible.

3. Legislation should be designed to avoid, at least in part, the growing trend to require manufacturers and sellers of products to warn against what would be an obvious negligent or improper use of the product, or to warn the user as to something the user was

required to know or do under federal or state laws or regulations.

4. The manufacturer or seller should have a defense where the damages arose from the use of a product that had been altered or modified subsequent to manufacture by someone other than the original manufacturer or seller. If a product is resold by the original user/purchaser, the manufacturer should no longer be held responsible for an accident on the product if it has been modified in any manner. The manufacturer has no control over the condition of the equipment after it leaves his plant, especially when the product has been resold two or more times.

5. An employer should be required by statute to give notice to the manufacturer of any accident involving the manufacturer's machinery or equipment within 30 days of the occurrence. Failure to do so would make the employer be fully liable for any and all damages sustained by the employee as a result of the injury. Far too often, an accident is not reported until just before the statute of limitations on filing a suit expires, and the manufacturer has little opportunity, if any, to inspect the product as it was at the time of the accident.

6. There should be no right for a jury to award punitive damages. A judge's opportunity to award punitive damages should be specifically limited and permitted only upon conclusive evidence that the manufacturer has been "wantonly negligent" in producing the product. Damages for "pain and suffering" should be capped.

7. An insurance company that has paid a worker's compensation claim should not be allowed to subrogate the manufacturer or seller of the product in question in order to reclaim the worker's compensation payments made to the injured party. Subrogation permits the insurance company to transfer the worker's compensation payments to the manufacturer of the product. In effect, they are permitted to collect twice, presumably without reducing the owner's premiums. This destroys the fundamental concept on which worker's compensation is based.

8. A suit which has been tried and found to be without merit should carry an obligation for the losing party and/or his attorney to reimburse the defendant for the costs of the suit and legal defense.

9. The 1965 Restatement of Torts has to be rewritten or at least clarified so that the policy of strict liability is eliminated in favor of a policy whereby awards are made according to proportionate fault. In the Restatement, the words "unreasonably" and "defective" are ambiguous and have not been properly defined. As a result, juries and judges have taken great liberties in expanding the meaning of these terms far beyond the original legislative intent.

I would like to add a 10th recommendation to my father's list. Congress should outlaw lawyers from entering into contingency fee arrangements - a practice deemed unethical and forbidden in England, France, West Germany, Norway, Sweden, Belgium, Switzerland, Italy and four Canadian provinces including Ontario. Our experience has shown that most suits are frivolous, filed only to collect what may be negotiated from the insurance carrier or the manufacturer. The only ways to prevent this type of suit are to penalize the filers of such suits and to eliminate the contingency fee. The contingency fee arrangement inures solely to the benefit of the tiny number of trial lawyers and individuals who view product liability suits in the way others view the $1,000,000 lottery. Sadly, the chief beneficiaries of contingency fee arrangements are the lawyers who receive between 33% to 40% on any judgment or settlement. The injured individual is lucky to clear an equal amount. Putting an end to the contingency fee arrangement would not only deter frivilous suits, but would put more money in the pocket of the truly injured victim.

Conclusion

Finally, as the fourth-generation president of Oliver Machinery Company, and as a third member of the Baldwin family to serve as president at WMMA, I would like to share a letter with you which was sent to me by J. G. White, Jr. the executive vice president of the association. His poignant reflections touch on the fears, frustrations, and desperation which many WMMA members are experiencing as a result of the liability crisis.

"In the 10 years since the White House Product Liability Conference and your father's appearance before the Senate Small Business Committee, the members of the Wood Machinery Manufacturers of America have suffered greatly from the effects of product liability on their businesses. We learned early on that they were very reluctant to quantify their problems publicly, even to the extent of not being willing to share with the association such sensitive information as the fact that they were dropping out of the business of manufacturing machinery because of product liability.

"However, in telephone conversations, at meetings and trade shows, whenever I am with them, it is the number one topic of concern. It is impossible to tell how many companies of the 113 who belong to WMMA are 'going bare' right now. I can only presume that at least a quarter or a third of them are. This is one of the sensitive areas they would prefer not to talk about because of the potential repercussions it might create if this information became public knowledge among the legal fraternity. My assumptions are based on the number of telephone calls I've gotten in the past 14 months from members complaining they've been told by their insurance broker that the carrier has cancelled their coverage and there's no other company willing to write insurance on them at any price. Can I help them? Unfortunately, I have to answer 'no'.

"Usually the next step that I hear about will either be the news that someone has bought them out, or they drop out of membership. My records indicate that we've lost a total of 34 companies from WMMA since January, 1976. On the other hand, we've had as many new companies join the association. However, the new companies are much smaller, usually in their first or second year of business and with a single line of machinery. Apparently it's much easier to start up a new, small company with a very limited line of machinery (and a very limited 'tail of exposure', incidentally) than it is to keep a fine old company going; a company that over the years may have been very innovative in bringing new technology to its customers in the furniture industry, or kitchen cabinets, or millwork, or a variety of other industries dependent on woodworking machinery.

"For several years, liability insurance was not a problem. The escalating costs of trials and settlements apparently were offset by the insurance companies' rising income. After an initial surge in premium levels in the mid-1970s, they leveled off, even dropped a little, until January of 1985. Suddenly the insurance companies seemed to be trying to make up for lost time. As each WMMA company's insurance policy came up for renewal, the premiums doubled, tripled and more. I heard from companies who were quoted rates sevenfold what the previous year's rate had been. And, the deductibles were being raised while the maximums were being lowered. All this was occurring without any relevant correlation to the company's experience. It is not unusual to hear -- as I did just a few weeks ago -- from a company complaining that they had not even had a suit filed against them in seven years but the premium was being raised from $74,000 a year to $453,000, and the deductible was being raised from $5,000 to $50,000 per case. In effect, the company was going to be self-insured on all but the disaster case.

"WMMA has been exploring group alternatives -- through a common carrier, setting up a captive or anything that would give us more control of our own destinies. Unfortunately, we're much too small even as an industry to be able to put together a captive. And there's a real risk in developing a group program with a single carrier when that carrier decides to cancel everyone at once, as happened to our sister association, the Woodworking Machinery Distributors Association. Suddenly, all these companies are thrown on the open market at once and the insurance industry has real trouble absorbing the additional risk.

"Insurance is not the only malfunction created by product liability. Wood working machinery manufacturers, by and large, are small businesses that grew out of the inventiveness of an engineer or woodworker who developed a better way to do some wood machining function and proceeded to build a company around the demand that his new idea generated. He is usually not a businessman. Or, at least he wasn't trained to be. As the business grew, he had to learn to be a businessman. Perhaps his business grew quickly and strongly enough that he could surround himself with the talent to handle the business while he devoted his energies to new ideas and improvements on existing machines.

"Product liability seems to have brought him to his knees. No longer at industry meetings do we hear much enthusiastic conversation about new developments. Now, it's 'how are you coping?' Or, 'What are you paying for insurance?' It seems the very heart and soul of the best in our industry has surrendered itself to concentrating on defensive strategies.

"Even worse, it doesn't seem that the next generation is coming into the industry as has always been the case. It almost seems as if the attitude is to let go, let the foreign concerns take over the industry; they don't have to worry about product liability. One company president told me recently that he was unable to get insurance at any price. He was tired of spending all his time worrying about defending his excellent machinery in case after case and not having enough time to even keep up with the current business. His admittedly defeatist attitude, probably brought on by strain, was, 'The next guy that sues me can have the business. Let him find out what it's like to run a machinery company. Maybe then he'll understand the headaches and heartaches he caused me.'"

Thank you, Mr. Chairman.

Senator **Kasten**. Mr. Baldwin, thank you very much.

Our final witness on this panel is Mr. S. Brian Simons, who is the president of OEM Controls, Inc., Shelton, CT.

STATEMENT OF S. BRIAN SIMONS, PRESIDENT, OEM CONTROLS, INC., SHELTON, CT

Mr. **Simons**. Mr. Chairman and members of the committee, my name is Brian Simons. I'm president of OEM Controls, which I started in 1966.

We manufacture joysticks and electronics used on construction, mining, and agricultural equipment I sent literature along with this writeup, and I notice the girls deleted it. They maybe thought I was trying to sell joysticks to the committee, but I was just trying to save questions.

We employ 50 people and have a sales volume of $4 million. We have weathered recessions, depressions, foreign competition. We are now confronted with a business crisis we cannot combat with hard work, good engineering, or high quality. We need your help.

In 1983 we were included in our first lawsuit as a third party defendant in a case in which a machine operator injured his arm. It was an unfounded claim. However, it was settled at the courthouse steps for $405,000 in December 1985.

Our insurance company portion was $75,000. Our out-of-pocket expenses for management's time and travel, for depositions, et cetera, was approximately $10,000.

In 1985 we were included in two suits. In both cases at depositions the plaintiffs' testimony clearly stated that our control was not at fault. However, our costs plus the insurance company's legal costs were in excess of $20,000.

Our situation, gentlemen, is we make a component that goes on a finished piece of equipment, and there is no way anybody can determine which component caused the problem, so they go after all components on the piece of equipment. We would have a switch on an Oliver machine, for instance, and we could get sued if someone cut their finger off on an Oliver machine.

In 1983 our liability premiums were $1,800. Last year they increased to $20,000 for the same amount of coverage. Last month the insurance company which we have had for 20 years informed us we were done as of April 1, 1986. To date, we have not been able to find a new carrier. The insurance agents say that if we get insurance at all, we can expect premiums of $200,000 for $1 million coverage with $50,000 deductible.

Our exposure has increased dramatically. We have lower coverage, and the total deductible amount is unforecastable. We cannot pass on—the whole theory of pass it on to the consumer, it doesn't work at the component level. We cannot pass it because if we passed on a 10-percent price increase to our customers, 5 percent for premium, 5 percent for deductible, they'd go shopping. Our large competitors have joysticks that are a small part of their line. They don't have the same reflection of costs that we do, and also foreign competition is insulated and has no assets to go after in this country.

Many of our customers are in the same predicament. Pierce Correll, Connecticut, manufactures aerial lifts. Last year their premiums went from $20,000 to $210,000. They produce apprioximately three lifts a month. In 1985 they were unable to pass on the $6,000 per lift, because of competitive reasons and because of contractual agreements. So this small company which produces a good product and has been in business is going slowly out of business with every monthly premium it has to pay.

Durnell Engineering, Emmetsburg, IA, again manufactures aerial lifts. In 1984 their premiums were $67,000 for $1 million in coverage. This year it was $168,000 for the same coverage. During their 19-year history they have only had one claim of $2,500 against their company.

Unfortunately, their previous carrier went bankrupt, and the only tail insurance they could find would cost them $200,000 and only provided 100,000 dollars' worth of coverage. Consequently, they're going bare for that period and currently face paying for their own defense on two groundless lawsuits.

Morris Durnell is a hell of a nice guy. He has 50 employees, but he's in trouble.

Another manufacturer's 1984 premiums were $41,000 for $10 million, $10,000 deductible; 1985 premiums were increased to $200,000 for $1 million coverage with $50,000 deductible. They're now paying $300,000 for $1 million coverage with $200,000 deductible—for each occurrence, gentlemen, not just the total deductible. And I have several other examples that are in my testimony.

The primary problem, as I see it, is with the legal system. I know a lot of you don't like to hear that, and I was advised not to say it.

Most States hold manufacturers strictly liable for injuries or damage caused by their products whether or not they are negligently designed or manufactured. We are guilty until proven innocent, and we cannot afford to prove our innocence.

Jury awards which are often based on the emotional appeal of the case have reached unprecedented heights in recent years. As a result of this unpredictability, insurance companies are afraid to defend even the most frivolous suits, so they settle the case with our money. We are being denied due process of law because no one is willing to go to court and risk these awards.

The system has fostered a legal form of extortion that squanders millions of dollars and countless man-hours and threatens our existence.

The plaintiff bar—excuse me, Mr. Bumpers; I didn't know that I would be facing you head to head—the plaintiff bar, spurred on by the lottery fever of possible windfall jury awards, solicits candidates for lawsuits. Last week I saw law firms advertising right on television stating that if you have been in a car accident or you have been hurt on someone's property, you're entitled to pain and suffering awards: "Please contact us for free legal advice"—XYZ Company.

This type of solicitation reflects the facts that liability litigation on the standard contingency fee basis can result in enormous fees for lawyers which far outweigh the time invested in the case.

A case in point is in Tuesday's Wall Street Journal, last Tuesday's Wall Street Journal:

Manville Corp. Creditors Will Ask Court To Set "Reasonable" Fees for Attorneys.

I quote:

> Manville Corp.'s reorganization plan is facing a final round of opposition from a committee representing commercial creditors who are zeroing in on the prospect that attorneys could get $1 billion in fees.

The legislation proposed by Senator Danforth, from what I understand about it—I'm not an attorney—I think would go a long way toward accomplishing this by replacing the unpredictable patchwork of State legislation. The problem we have is that we never know where our products go, in which State it's going to go, so there would be no way we could predict or an insurance company could predict what our exposure was if we had to depend on individual State legislation.

I think the real thing that's going to help in that is that it cannot be watered down. If a plaintiff chooses to sue in court, he must prove that the manufacturer was negligent. If he elects to seek economic damages direct from the manufacturer, he must be precluded from suing in court later.

I think, gentlemen, that the Government has been successful in both protecting the employer and compensating the injured employee through workers' compensation, and I am confident that you gentlemen—and I certainly appreciate your putting in some real time on this, but it is a problem that is hitting us right now. Whatever measures are taken must be taken right now. Small business can't hold out much longer.

I'm sure Congress would not pass a law which would eliminate small business, but failure to pass product liability legislation immediately may have the same effect.

Thank you for your time.

[The prepared statement of Mr. Simons follows:]

STATEMENT OF S. BRIAN SIMONS, PRESIDENT,

O.E.M. CONTROLS, INC.

MR. CHAIRMAN, MEMBERS OF THE SENATE SMALL BUSINESS COMMITTEE:

MY NAME IS BRIAN SIMONS, AND I'M PRESIDENT OF OEM CONTROLS, INCORPORATED, WHICH I STARTED IN 1966. WE MANUFACTURE JOYSTICKS AND ELECTRONICS USED ON CONSTRUCTION, MINING, UTILITY, AND AGRICULTURAL EQUIPMENT. WE EMPLOY 50 PEOPLE AND HAVE SALES OF $4 MILLION. WE HAVE WEATHERED RECESSIONS, DEPRESSIONS, AND FOREIGN COMPETITION. WE ARE NOW CONFRONTED WITH A BUSINESS CRISIS THAT WE CANNOT COMBAT WITH HARD WORK, GOOD ENGINEERING, OR HIGH QUALITY. WE NEED YOUR HELP.

WE HAVE BEEN IN BUSINESS 20 YEARS. IN THE FIRST 16 YEARS, WE WERE NOT INVOLVED IN ANY LAW SUITS. IN 1983, WE WERE INCLUDED AS A THIRD PARTY DEFENDANT IN A CASE IN WHICH A MACHINE OPERATOR INJURED HIS ARM. IT WAS AN UNFOUNDED CLAIM. HOWEVER, IT WAS SETTLED ON THE COURT HOUSE STEPS FOR $405,000 IN DECEMBER, 1985. OUR INSURANCE COMPANY'S PORTION WAS $75,000. OUT-OF-POCKET EXPENSES FOR MANAGEMENT'S TIME AND TRAVEL FOR DEPOSITIONS, ETC. WAS APPROXIMATELY $10,000.

IN 1985 WE WERE INCLUDED IN TWO LAW SUITS. IN BOTH CASES, AT DEPOSITION, THE PLANTIFF'S TESTIMONY CLEARLY STATED THAT OUR CONTROL WAS NOT AT FAULT. HOWEVER, OUR COSTS AGAIN FOR MANAGEMENT TIME AND TRAVEL, AND OUR INSURANCE COMPANY'S LEGAL COSTS WERE IN EXCESS OF $20,000.

IN 1983 OUR LIABILITY PREMIUMS WERE $1,800. LAST YEAR THEY WERE INCREASED TO $20,000 FOR THE SAME AMOUNT OF COVERAGE. LAST MONTH THE INSURANCE COMPANY ADVISED ME THAT THEY WILL NOT RENEW MY POLICY. TO DATE, I'VE BEEN UNABLE TO FIND A NEW CARRIER, AND MY INSURANCE AGENTS SAY THAT IF WE CAN GET INSURANCE AT ALL, WE CAN EXPECT HIGH PREMIUMS OF $200,000 FOR $1 MILLION OF COVERAGE WITH A $50,000 DEDUCTIBLE PER OCCURENCE. OUR EXPOSURE HAS INCREASED DRAMATICALLY. WE HAVE LOWER MAXIMUM COVERAGE, AND THE TOTAL DEDUCTIBLE AMOUNT IS UNFORECASTIBLE. WE CANNOT PASS ON OUR INCREASED PREMIUM COSTS FOR COMPETITIVE REASONS. IF WE INCREASED PRICES 10% (5% FOR PREMIUM, 5% FOR DEDUCTIBLE), OUR CUSTOMERS WOULD GO SHOPPING. LARGE COMPETITORS ARE SELF-INSURED.

JOYSTICKS ARE A SMALL PART OF THEIR SALES VOLUME. FOREIGN COMPETITORS ARE INSULATED AND HAVE FEW ASSETS TO GO AFTER IN THIS COUNTRY.

MANY OF OUR CUSTOMERS ARE IN THE SAME PREDICAMENT. PIERCE CORRELL, IN MILFORD, CONNECTICUT, MANUFACTURES AERIAL LIFTS FOR THE UTILITY INDUSTRY. LAST YEAR THEIR LIABILITY PREMIUMS WENT FROM $20,000 TO $210,000. THEY PRODUCE APPROXIMATELY 3 LIFTS PER MONTH. IN 1985 THEY WERE UNABLE TO PASS ON THE $6,000 PER TRUCK INCREASE DUE TO COMPETITIVE AND CONTRACTUAL AGREEMENTS. THEY ARE A SMALL COMPANY WITH A GOOD PRODUCT WHOSE CHANCES OF SURVIVAL DECREASE WITH EVERY MONTHLY PREMIUM PAYMENT.

DURNELL ENGINEERING IN EMMETSBURG, IOWA, MANUFACTURES AERIAL LIFTS. THEIR SALES VOLUME IS $3 MILLION PER YEAR. THEIR ANNUAL INSURANCE PREMIUMS WERE $12,000 FOR $4 MILLION WORTH OF COVERAGE TWO YEARS AGO. LAST YEAR THEIR PREMIUMS INCREASED TO $67,000 FOR $1 MILLION WORTH OF COVERAGE, AND THIS YEAR THEIR PREMIUMS INCREASED TO $168,000 FOR THE SAME COVERAGE. DURING THEIR 19-YEAR HISTORY, THEIR INSURERS HAVE ONLY PAID ONE CLAIM IN THE AMOUNT OF $2,500 PLUS LEGAL FEES. UNFORTUNATELY, THEIR PREVIOUS CARRIER WENT BANKRUPT. THE ONLY TAIL INSURANCE THEY COULD FIND COST $200,000 AND ONLY PROVIDED $100,000 COVERAGE FOR PRODUCTS MANUFACTURED WHILE THEY WERE INSURED BY THE BANKRUPT CARRIER. CONSEQUENTLY, THEY ARE GOING "BARE" FOR THAT PERIOD AND ARE CURRENTLY FACED WITH PAYING FOR THEIR OWN DEFENSE IN TWO GROUNDLESS LAW SUITS.

ANOTHER MANUFACTURER OF AERIAL LIFTS, WHO HAS ASKED TO REMAIN NAMELESS BECAUSE OF THEIR CURRENT INSURANCE PREDICAMENT, HAS HAD SIMILAR EXPERIENCES. IN 1984 THEIR PREMIUMS WERE $41,000 FOR A $10 MILLION POLICY WITH A $10,000 DEDUCTIBLE. IN 1985 THEIR PREMIUMS WERE INCREASED TO $200,000 FOR $1 MILLION WORTH OF COVERAGE WITH A $50,000 DEDUCTIBLE. THIS YEAR THEY ARE PAYING $300,000 FOR THE SAME $1 MILLION COVERAGE WITH A $200,000 DEDUCTIBLE. THEIR ANNUAL SALES VOLUME IS APPROXIMATELY $10 MILLION.

LINEMASTER SWITCH IN WOODSTOCK, CONNECTICUT, MANUFACTURERS ELECTRICAL FOOT PEDALS. WE HAVE SEVERAL CUSTOMERS IN COMMON. THEIR ANNUAL SALES VOLUME IS APPROXIMATELY

$7 MILLION. THIS YEAR THEIR INSURANCE PREMIUMS WERE INCREASED AN UNPRECEDENTED 415% TO APPROXIMATELY $400,000.

AT THE END OF THIS CHAIN REACTION IS THE SMALL, HEAVY EQUIPMENT OPERATOR:

RIDGDILL AND SON CONSTRUCTION USES EQUIPMENT THAT UTILIZES OUR JOYSTICK FOR CONTROL. THEIR PREMIUM FOR LIABILITY INSURANCE WAS $30,000 IN 1984, $75,000 IN 1985, AND THE INSURANCE CARRIER IS CANCELING HIS INSURANCE THIS MONTH. IF HE CANNOT GET INSURANCE, HE WILL CLOSE DOWN AND PUT 30 PEOPLE OUT OF WORK.

THE PRIMARY PROBLEM AS I SEE IT IS WITH THE LEGAL SYSTEM. MOST STATES HOLD MANUFACTURERS STRICTLY LIABLE FOR INJURIES OR DAMAGE CAUSED BY THEIR PRODUCTS WHETHER OR NOT THEY WERE NEGLIGENTLY DESIGNED OR MANUFACTURED. WE ARE GUILTY UNTIL PROVEN INNOCENT, AND WE CANNOT AFFORD TO PROVE OUR INNOCENCE. JURY AWARDS, WHICH ARE OFTEN BASED ON THE EMOTIONAL APPEAL OF THE CASE, HAVE REACHED UNPRECEDENTED HEIGHTS IN RECENT YEARS. AS A RESULT OF THEIR UNPREDICTABILITY, INSURANCE COMPANIES ARE AFRAID TO DEFEND EVEN THE MOST FRIVOLOUS SUITS, SO THEY SETTLE THE CASE WITH OUR MONEY. WE ARE BEING DENIED DUE PROCESS OF LAW BECAUSE NO ONE IS WILLING TO GO TO COURT AND RISK THESE AWARDS. THE SYSTEM HAS FOSTERED A LEGAL FORM OF EXTORTION THAT SQUANDERS MILLIONS OF DOLLARS, COUNTLESS MAN HOURS, AND THREATENS OUR EXISTENCE.

THE PLANTIFF BAR, SPURRED ON BY THE "LOTTERY FEVER" OF POSSIBLE WINDFALL JURY AWARDS, SOLICITS CANDIDATES FOR LAWSUITS. LAST WEEK I SAW A LAW FIRM'S ADVERTISEMENT ON TELEVISION. IT STATED THAT IF YOU HAVE BEEN IN A CAR ACCIDENT OR INJURED ON SOMEONE'S PROPERTY, YOU ARE ENTITLED TO COMPENSATION - CALL US. THIS TYPE OF SOLICITATION REFLECTS THE FACT THAT LIABILITY LITIGATION, ON THE STANDARD CONTINGENCY FEE BASIS, CAN RESULT IN ENORMOUS FEES FOR LAWYERS WHICH FAR OUTWEIGH THE TIME INVESTED IN THE CASE. A CASE IN POINT APPEARED IN TUESDAY'S "WALL STREET JOURNAL."

"MANVILLE CORP. CREDITORS WILL ASK COURT TO SET 'REASONABLE' FEES FOR ATTORNEYS"

> "MANVILLE CORP.'S REORGANIZATION PLAN IS FACING A FINAL ROUND OF OPPOSITION FROMM A COMMITTEE REPRESENTING COMMERCIAL CREDITORS, WHO ARE ZEROING IN ON THE PROSPECT THAT ATTORNEYS COULD GET $1 BILLION IN FEES."

IT SHOULD BE NOTED THAT I'M NOT UNSYMPATHETIC TO THE PLIGHT OF THE CONSUMER WHO HAS BEEN INJURED AS THE RESULT OF A MANUFACTURER'S NEGLIGENCE. I DO NOT MAINTAIN THAT A NEGLIGENT MANUFACTURER SHOULD BE PROTECTED FROM TAKING FULL FINANCIAL RESPONSIBILITY FOR THE DAMAGE OR INJURY WHICH IT HAS CAUSED.

ON THE OTHER HAND, SOMETHING HAS TO BE DONE TO BRING LIABILITY AWARDS BACK TO REALITY. WE HAVE TO DEVELOP A FAIRER AND MORE PREDICTABLE METHOD OF COMPENSATING THE INJURED PLAINTIFF.

IT SEEMS TO ME THAT THE LEGISLATION PROPOSED BY SENATOR DANFORTH AS S.1999 WOULD GO A LONG WAY TOWARDS ACCOMPLISHING THIS BY REPLACING THE UNPREDICTABLE PATCHWORK OF STATE LEGISLATION, BUT IF IT'S REALLY GOING TO HELP, IT CAN'T BE WATERED DOWN. IF THE PLAINTIFF CHOOSES TO SUE IN COURT, HE MUST BE HELD TO PROVING THAT THE MANUFACTURER WAS NEGLIGENT. IF HE'S NOT, WE WILL BE RIGHT BACK IN THE SAME SITUATION THAT WE'RE IN NOW. IF HE ELECTS TO SEEK ECONOMIC DAMAGES DIRECTLY FROM THE MANUFACTURER, HE MUST BE PRECLUDED FROM SUING IN COURT LATER. ADDITIONALLY, IF THE PLAINTIFF DOES SUE, ATTORNEY CONTINGENCY FEES SHOULD BE LIMITED BY AN INVERSE SLIDING SCALE. THIS WILL HELP ASSURE THAT THE LAWYER ISN'T REAPING A WINDFALL FEE AT THE PLAINTIFF'S EXPENSE.

I DON'T HOLD MYSELF OUT AS AN EXPERT AS TO WHAT THE BEST POSSIBLE SOLUTION IS, BUT GOVERNMENT HAS BEEN SUCCESSFUL IN BOTH PROTECTING THE EMPLOLYER AND COMPENSATING THE INJURED EMPLOYEE THROUGH WORKER'S COMPENSATION, AND I'M CONFIDENT THAT YOU ARE CAPABLE OF

PROVIDING SIMILARLY EFFECTIVE LEGISLATION IN THE AREA OF PRODUCT LIABILITY. WHATEVER LEGISLATIVE MEASURES ARE TAKEN, MUST BE TAKEN NOW.

SMALL BUSINESS CAN'T HOLD OUT MUCH LONGER.

I'M SURE THAT CONGRESS WOULDN'T PASS A LAW WHICH WOULD ELIMINATE SMALL BUSINESS BUT FAILURE TO PASS PRODUCT LIABILITY LEGISLATION IMMEDIATELY MAY HAVE THE SAME EFFECT.

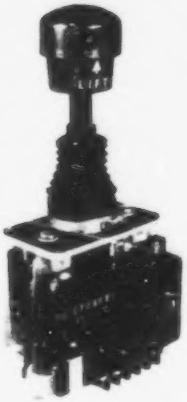
I URGENTLY REQUEST YOUR MOST VIGOROUS EFFORTS TO PASS A FEDERAL PRODUCT LIABILITY NOW.

SBS:JGR

OEM controls, inc.

Electro/Hydraulic Valve Controllers

JS3



MS4

Why You Should Be Using Electro/Hydraulic Valve Controllers
Engineered And Built By OEM Controls, Inc. . . .

- Heavy duty mechanical construction.
- Modular design provides maximum flexibility.
- Operates all electro hydraulic valves.
- Industrial grade electronic components.
- Solid state reliability.
- Circuit boards integrated with controller.
- UFO electronics* (Ultra Feathering Operation).

*UFO electronics is a combination of threshold adjustment to eliminate "dead band," maximum output adjustment to tailor output precisely to valve requirements and dither to overcome hysterisis and "stiction."

10 Controls Drive • Shelton, Connecticut 06484 • 203-929-8431

Specifically Engineered for Electro/Hydraulic Applications

Standard Features

JS3 Single or Dual Axis

Standard

- Heavy duty construction. Circuit boards are built onto the bottom of the controller and do not add to panel space required.
- 3/32" thick Fiberglass pc boards with proper heat-sinking.
- Wide pot drive gear surfaces provide minimal play, long life.
- Large bearing surfaces for rugged, long life operation.
- Weathertight.
- Pot rotation 215°
- Handle travel (each axis) 60°
- Cap handle.

Options

- UFO *current* controlled electronics for electro/hydraulic valves and strokers.
- UFO *voltage* controlled electronics for electro/hydraulic valves and strokers.
- Either heavy duty spring return or friction hold with adjustable tension.
- Full range of UFO electronic features (see page 3).
- RG - Rocker grip handle with auxiliary switches.
- H and other special gates.
- Non-simultaneous gate.
- Long life potentiometers.
- V3 micro switches.

Specifications — JS3
Operating Temp. Range − 40/ + 70°C
Boot Material Poly Vinyl Chloride (PVC)
Expected Life 3,000,000 + cycles

MS4 Single Axis

Standard

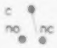
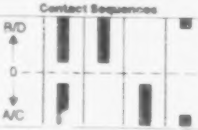
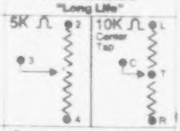
- Compact, rugged construction.
- Weathertight.
- Cap handle.
- Wide pot drive gear surfaces provide minimal play, long life.
- Adjustable switch cams.
- Pot rotation 300°
- Handle travel 75°
- 1/16" thick Fiberglass pc boards with proper heat-sinking.

Options

- UFO *current* controlled electronics for electro/hydraulic valves and strokers.
- UFO *voltage* controlled electronics for electro/hydraulic valves and strokers.
- Mechanical interlock handle which prevents accidental actuation.
- Adjustable friction hold (center rest detent is included with this option).
- Full range of UFO electronic features (see page 3).
- Zero rest, and 1, 2, and 3 speed detents.
- RG - Rocker grip handle with auxiliary switches.
- Auxiliary (dead man) switch in cap handle.
- Dual effort return spring.
- Enclosures.
- Long life potentiometers.
- V3 micro switches.

Specifications — MS4
Operating Temp. Range − 40/ + 70°C
Boot Material Poly Vinyl Chloride (PVC)
Expected Life 1,000,000 + cycles

(Electrical Specifications)

V3 Switch Specs	Switch Configuration	Life	Contact Sequences	Potentiometers "Long Life"
11 a. ½ Hp 125-250-277 V.A.C. 10 a. to 36 V.D.C. 4 a. at 48 V.D.C. 5 a. at 125 V.D.C.	 Form "C" Single Pole Double Throw	10,000,000 Cycles with 95% Survival		 5K Ω 2 3 4 10K Ω Center Tap L C T R
V3 Micro Switches (4) Maximum per axis JS3 (6) Maximum per axis MS4 (4) Maximum with pot MS4				Potentiometer - wired to terminal board

UFO Electronics Provide Precise Proportional Control

(UFO Ultra Feathering Operation)

Standard Features with UFO Electronics:

Pulse Width Modulation—The pulse width modulated output helps overcome the effects of hysteresis, stiction, hydraulic pressures, and mechanical tolerances that inhibit the operation of proportional electro hydraulic valves and strokers.

Threshold Adjustment—Eliminates "dead hand" in valve response at the start of handle movement, thus providing proportional control over the entire control lever travel.

Maximum Output Adjustment—Provides an adjustable maximum output level utilizing full handle travel regardless of the maximum output limit setting.

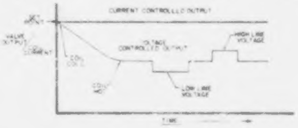
Voltage Controller—If the Current Controller features are not necessary and cost is of primary importance, a voltage controlled UFO is available. This UFO board will provide dither and adjustable threshold and maximum output, also available with IRS option.

Diagnostic Light Emitting Diodes (LED's)—These indicators simplify troubleshooting of the entire control circuit without external testers by indicating the presence of controller output voltage. They can be used to differentiate between a fault that has occurred in the valve coil, valve coil wiring, or the controller itself.

Limited Adjustment Interaction—Interaction of the threshold and maximum output adjustment has been kept to a minimum by careful circuit design.

Current Controller—This feature guarantees that the output of the controlled valve or stroker remains constant regardless of fluctuation in the supply voltage, or variations in coil impedance due to operating temperature changes. Our Current Controlling circuit is unique in that it takes into consideration the current "stored" in the inductive coil of the valve. This "stored" current introduces an error signal that can adversely affect the positioning of the spool and, if not controlled, will allow erratic fluctuation of the spool position. This stored current is especially troublesome in pulse width modulated circuitry where the current is constantly being turned on and off. Another advantage is the short circuit and over current protection inherent to current control.

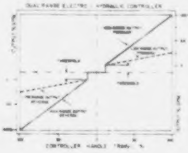
With a nominal 12 volt system at normal ambient temperatures, the output current will remain constant within 1% with an input supply varying between 8 and 18 volts DC, or a coil impedance increase as high as 100% above its nominal cold value. The new large aluminum heat sink protects all the electronic components on the circuit board from mechanical damage and the possibility of electrical shorts by foreign objects.



Optional Features:

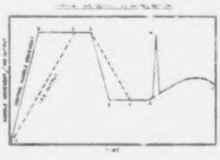
The **Dual Range** feature provides two different output ranges that can be pre-set and then selected by closing a switch contact manually or automatically via the equipment being controlled.

Typical applications include limiting the operating speed when inexperienced operators are being trained, or when operating equipment under critical conditions requiring slow precise movements.



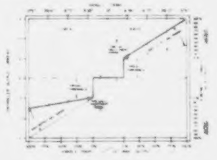
The IRS **(Integrated Ramp System)** is an adjustable ramping circuit that ensures smooth hydraulic system response. The ramp circuit limits the *rate of change* of the output to the set limits, eliminating the jerky response normally associated with jerky handle movements.

If the handle is moved faster than the set "ramp" rate, the change in the valve output will be automatically limited to the set "ramp" rate.

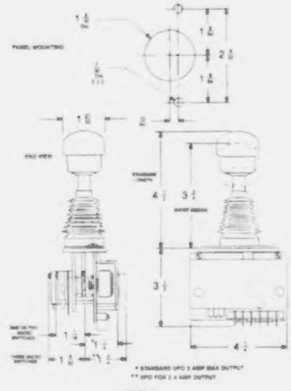


The **Dual Maximum Output** feature provides separate maximum output limits in each direction of handle travel. This adjustment can be used to compensate for the imbalance of output in each direction that is characteristic of most hydraulic circuits.

It can also be used to purposely create an imbalance in output. For example when maximum forward speed is required, but a limited reverse speed is necessary.



Dimensional Specifications

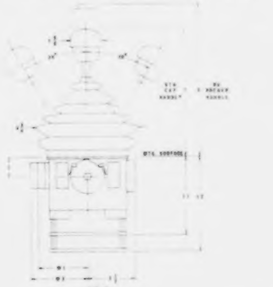


* STANDARD UFO 2 AMP MAX OUTPUT
** UFO FOR 2.4 AMP OUTPUT

MS4

KEY	NO. OF CONTACTS	NO. OF CONTACTS W/PCB & POT 2 CIRCUITS TOTAL [illegible]	DIM. IN INCHES
W 1	1 – 2	1 – 2	3
W 2	3 – 4	3 – 4	3 5/8
X 1		1 – 2	4 1/8
X 2		5 – 6	5 1/8

PANEL MOUNTING DETAIL



JS3

Other Products

(See the complete Catalog for details)

FP2 Foot Pedal

This rugged cast aluminum foot pedal is available with internal potentiometer and/or micro-switches, or UFO electronics. It is weathertight and features the same ultra-reliable return spring mechanism as the JS2 and JS3 controllers.

JS2 1, 2 and 3 Axis Controller

The JS2 is the most versatile in our line. With as many as 14 switches per axis, pot. drives and many special options, the JS2 has the flexibility and ruggedness for any application.

RG Rocker Grip Handle

Available on our JS1, JS2, JS3, and MS4 controllers, this handle further extends their versatility. It is available with a pair of S.P.S.T. switches actuated by the rocker assembly in the top, plus a S.P.S.T.N.O. switch in the side or top, or any combination of these switches.

MS2 Single Axis Controller

The single axis controller has a cast upper housing instead of the boot type construction of the MS4. The "O" ring-sealed operating shaft and gasketed mounting flange guarantees weather tightness. Spring returned or friction held handle along with microswitches and potentiometers provide versatility.

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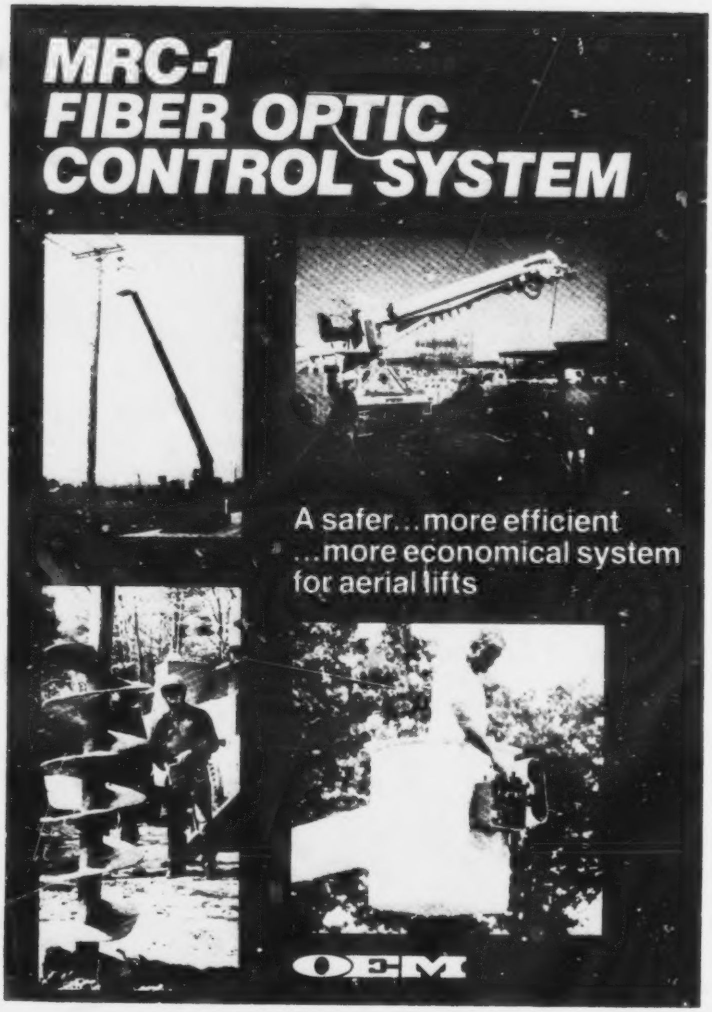

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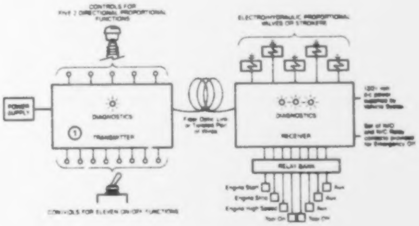
MRC-1 MULTIPLEXED REMOTE CONTROL

The fiber optics system that makes hydraulic control obsolete

The conversion of full or pilot pressure hydraulics to the MRC-1 Fiber Optics System produces results so dramatic that it affects virtually every function of boom and bucket operations State-of-the-art electronics is combined with electro hydraulic technology creating a level of controllability never before achieved The system permits a more precise control of hydraulic functions, greatly increases operator safety creates a cleaner working environment, reduces down time, lessens operator fatigue, and in the final analysis, lowers operating costs

The reliability and simplicity of the system are derived by multiplexing or combining many control signals into one, and transmitting this signal by a single fiber optic cable Initially developed for the utility aerial lift market where electrical operator isolation is critical, it is applicable to any situation where the operator needs isolation and mobility, such as the umbilical cord control of digger derricks

In the MRC System, a single core fiber optic cable replaces ten or more hydraulic and air hoses, and obsoletes manual hydraulic valves, pneumatic control systems and associated hardware The elimination of these components results in increased safety less maintenance and more efficient operation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Senator **Kasten**. Thank you for your testimony. I just want to make a comment. A couple of years ago, when some of us began, and we've done some work with the Wood Machinery Manufacturers Group and others, I think people were kind of saying that we were crying in the wind, that there wasn't really a problem, that it was just a narrow problem that might affect the machine tool industry or the wood manufacturers industry. And I think that this year in particular, not only is this a problem, it's a huge problem; it's a growing problem; it's affecting small business, large business, all different kinds of business; and it's just crying out for some kind of a solution. And I'm optimistic that we're going to find it.

And I also might say that there are a number of lawyers that are working hand in hand with me, and with others, who are trying to find a solution. Although we have mostly small business people represented on these panels today, there are a number of people who are attorneys who are working to try to find a solution and recognize some of the problems that you're outlining here.

Mr. Baldwin, with outlawing the contingency fees—let me say that there's a cry for that. And I personally don't believe that that's a workable solution. I don't think it's a correct solution. But as long as we have people resisting any other kinds of change, there's a growing, growing push to eliminate contingency fees and do other kinds of things.

I would like to explore, if I could, the question that was raised—in different ways—by three out of four of the panelists having to do with the issue of state-of-the-art technology, bringing on the fear of developing new products and selling new products. And specifically, the instance in which the 1985 improved product is being used as evidence that the 1975 product was somehow made dangerously or made wrong.

And the result of that is two. No. 1, people are hesitant to bring out the new, improved 1985 product; but No. 2, we're seeing people who have been doing their best at developing state-of-the-art products being penalized for making these improvements. So you're penalized for improving, and you're also afraid to bring out the new product.

The classic example of this is the Ruger pistol in which the Ruger Co., improved the safety on its pistol; it made it better. The result of that has been that there are one or two individuals going around the country, trying to find as many of these accidents as they can, and they've got a little kit. If they don't have time to try the case themselves, they sell the kit to another attorney, and then he takes it. And this is the step one, step two, step three.

Now, that is the classic example. But I would like, beginning with Mr. Neely, you referred to this whole question and problem about the failure to make improvements or recognizing problems as you make improvements; and then specifically, the example in which your newer model is being used as evidence that somehow your older model was either dangerous or that you were somehow at fault or whatever. And I'd like then, just beginning with Mr. Neely, to have others' comments specifically on this issue, the state-of-the-art question, and then examples—if you have any—in which the newer product is being used as evidence that the older product is unsafe or you were somehow at fault. And particularly in a company that has been going on for three or four generations, there have got to be a number of examples that would fit into this category.

Mr. Neely.

Mr. Neely. Thank you, Mr. Chairman.

This is one specific example. Our machines, again, traditionally last 25 to 30 years in the marketplace; the first one that was ever made is still running.

One of the things that we did in the early 1960's, we had a product liability specialist come in and look at the machines and recommend changes to make the machines more safe. It was really a safety issue than it was, at that time, a product liability issue, with the warning decals and this type of thing that go on the machines. I specifically entered the used equipment business to go buy machines because a number of people were rebuilding them without the new safety logos and new lockout devices that were involved in there.

So far, I have not had a claim or a suit since 1979. If I get in one, I guarantee you I'll see a picture of a machine that was made in 1950 with no warning decals on it, versus our new machine. I would do that if I were the attorney for the plaintiff.

But it's very difficult. We send back kits; these machines are hard to find, and some of them have changed owners 10 times. We can't even find them. When we do recognize there has been a problem, it's our responsibility to go back and update it where we do find a problem with a machine that could potentially cause an accident.

It's very difficult to locate these machines. We've sent registered, certified letters that go through 10 owners; sometimes you can't find it. Sometimes the machine is still scrap. But that's a very difficult problem for us.

Senator Kasten. Mr. Baldwin.

Mr. Baldwin. Thank you, Mr. Chairman. We also have the exact same problem. We've had machines—table-size, for example—that back in the 1920's and 1920's were shipped; they had guards which meet today's standards, but they didn't have the warning notices because back then people understood that if you put your finger in a sawblade, you're going to get it cut off. Now, today, you have to be told. Too many times, a machine will be in the stream of commerce for 20, 30, 50 years, and then will come up—someone will have an accident on it, and the lack of warning labels—the fact that they were not on when the machine was shipped, back in the 1930's or 1940's—is thrown right back in our face. We include those warning labels today because that's what the state of the art is in warning people.

One of our association's members, Peterson Panel Saw Co., out on the west coast, has designs—or the ideas for designs—for new machines to upgrade and improve the panel saws that they make. Their owner feels that they can double the size of their company within five years if they could dare bring these designs out; but they also know if they have an accident, they'll be thrown right back at them in court. As a result, they are feeling very much constrained in the way that they can grow. It is impacting jobs. They are a small company; they only have five people working for them, so a growth like that would be not a tremendous impact on their community, but five more jobs in any one small industry is a good help. And story after story of each different case that's going through that we have—we have an average of about nine suits a year. Taking the number of machines that we have out, and the average life of those machines as best we can estimate them, and using the equivalent of 1,000 hours a year, which is relatively limited—if you drove a car the same way, it would the equivalent of having one accident every 160 million miles in a single car. And yet we still pay this tremendous burden.

Our insurance went up last year 392 percent. We had a $10 million umbrella; we now have a $1 million umbrella. We have a $200,000 self-retention layer; our stop-loss, our aggregate last year was $500,000. This year, it's $800,000.

Senator **Bumpers**. Do you think your insurance company is reasonable in that?

Mr. **Baldwin**. The primary reason, Senator Bumpers, that we went to the large self-retention layer was to get control of the situation as best we could from the position where we were. From 1975 through the middle of 1978, we were insured with one of the largest insurance companies in the country, First Dollar Insurance. They paid out over $700,000—almost $700,000; it was $690,000-some—of settlements and judgments in those 3½ years, claims filed during those 3½ years.

In the 7½ years since then, we've paid out less than $400,000, primarily because we went after every single one just as aggressively as we could.

The problem is one where the insurance companies are running scared. It's not just an insurance problem; it's the atmosphere under which they're operating. If we don't reform the tort system in some meaningful way to get away from absolute liability, strict liability, we are simply not going to have small business people in this country able to survive.

It's partly an insurance problem, but it is not solely, by any stretch of the imagination.

Senator **Kasten**. Mr. Hess, could you respond to the question of state-of-the-art versus new developing technology?

Dr. **Hess**. Yes. You might think that I, as a service business, would find that question irrelevant. It is very relevant. First of all, as far as the direct impact, I concern myself more about a suit that I might get for work that I did 5 years ago when state of the art equipment, say, would have been sensitive to 10 parts per million of a given substance; and now, state-of-the-art equipment is likely sensitive to 10 parts per billion. And even though I would have reported then a "no detectable level" of material there, if there was something there that I would be able to find now, I'm quite sure that I could be held responsible for it.

From a bit broader perspective, our company is really in the business of providing technological services to small manufacturers and other companies who choose to use us rather than to perform their research and development in house. I have seen a tremendous shift from what I'll call creative/innovative assistance that we were able to provide to small companies, across to doing work for them of a defensive nature. Even though we've talked here a lot about the cost of insurance premiums and the inability to get coverage and what it might do to us financially, a "difficult to quantify"—and yet major—factor is the distraction imposed on the creative minds of small business persons that have to spend time worrying about how we're going to protect ourselves. I probably spend 10 percent of my time presently with lawyers and in conversations as to how our company is going to survive some of the threats that are out there, that I wouldn't have worried about 10 years ago.

Senator Kasten. Mr. Simons, the same question?

Mr. Simons. Yeah. I think we have a real good case in point.

In 1981, we started on an R&D project to use fiber optics in lieu of wires so that we could open up a whole new market for our joysticks in the utility truck market. And I spent a lot of money, a lot of time, bought equipment for it, etc.

If I knew today my potential risk—because this is a business which exposes more to injury—if I knew in 1981 what I know today, I might have taken those dollars and put them into some less technological development or high-tech project, and stuck to my knitting and kept the growth of my company down. So it has a definite impact on the decisions we make.

Senator Kasten. Senator Bumpers?

Senator Bumpers. I have no questions.

Senator Kasten. I'm just looking ahead, and we have several other witnesses.

I'd like to thank you all for your testimony here today, and we will continue to work with you.

Our next panel will include Ms. Silverman, Ms. Ehrnman, Mr. Lipshie, and Mr. Brine.

The committee will come to order.

Our first witness on this panel is Ms. Judy Silverman, who is the codirector of the Jackson Child Care Program in New Haven, CT. Judy.

STATEMENT OF JUDY J. SILVERMAN, CODIRECTOR, JACKSON CHILD CARE PROGRAM, INC., NEW HAVEN, CT

Ms. Silverman. Thank you, Mr. Chairman.

I am the codirector of the Edith B. Jackson Child Care Program. We are affiliated with Yale University, our program was named for a pediatrician and professor at Yale.

We are a family day care program serving approximately 45 children. Our program is now in its 13th year of operation, and is organized as a nonprofit corporation with its own board of directors. It is one of six child care facilities affiliated with Yale and has a program notable in several respects.

I'm going to not read all of my prepared testimony; I'll just briefly describe it.

We have seven day care homes which we operate as part of our program; and in addition, we have our Toddler Center for 2 to 3½ year olds and a nursery program for our older children, the 3½ to 5 year olds. To ensure a high level of care within each of the home settings as well as the Toddler Center and Nursery, we have a three-part interview process for candidates, an intensive training period for day care providers before each year begins, as well as regular staff meetings, periodic visits to the day care homes, and backup arrangements for care givers when they become ill.

This really is not the norm when it comes to family day care which are more typically loosely supervised by a State Department of Human Resources or Child Care Services.

Ours has been called a model program educationally, and it has received some national recognition. In terms of liability or injury, we have never had a claim brought against us. Our design is supportive of families, and it is also expensive and labor-intensive.

We have, this year, an operating budget which is a deficit budget. We have approximately $137,000 as our total budget, and we're projecting a deficit of just under $4,000. And this was before the increases in our liability insurance rates.

The availability of our general liability insurance has been a serious problem for us. Our insurance policy was canceled last year. We received the policy that we had through the National Association for the Education of Young Children [NAEYC] from the Forrest T. Jones Insurance Co.; its underwriter was National Union Fire Insurance Co. They canceled us out of hand last year, and we scrambled around, finally managing to find other coverage. What we replaced was, from $378 coverage for the previous year—this year it has gone to $1,600. And next month, in March, it's going up to $2,400 for the following year, March to March.

Now, the people who have spoken before me are talking about many thousands of dollars of insurance. This small amount $2,400, is for us, a major portion of our budget. The $4,000 deficit we projected to begin with, plus this $2,400, is really going to be a problem for us to come up and meet.

The increase was 634 percent for us. Other day care centers that I spoke with have increases as well—one, for example, went from $535 to $4,300 in 1 year. This is also a Yale-affiliated day care program. This means that it is a program which is recognized and respected in the New Haven community; it has never had a claim against it, as we have never had a claim against us.

A third program, the Saugatuck Child Care Services Program, reported before Representative Miller's committee in the House which held hearings on the same issues. Their insurance went from $6,000 to $17,000. They are also in the family day care business. That distinguishes them and us from a center-based program in that we have, in a sense a greater burden of responsibility. In a center-based program one can control this supposed issue of child abuse more easily because children, teachers, and directors are all under one roof. We at EBJ have different homes which we must visit to supervise, and we must depend on our judgment when we hire people that they are going to be competent at what they do.

In addition to losing our liability coverage, our umbrella policy was canceled and we have not been able to find anything to replace it at any price, so we are now going without umbrella coverage.

Workman's comp and nonowned auto policies were also canceled, but we've replaced that at about the same rate so that is not a problem for us.

The effect of this major increase in liability insurance cost on our program is severalfold. Our ability to continue a program of excellence for the care of children is placed in serious jeopardy by the burden of these insurance rate increases. Moreover, these increases have forced us to interrupt some important goals; one is putting in place a scholarship program for children, a second is upgrading our teachers' and caregivers' salaries.

In addition to the financial stress, there are institutional and personal concerns due to our inability to find umbrella coverage. As directors, my codirector, Barbara Klein, and I both feel personally vulnerable now that our coverage is lessened. With no coverage for child abuse as well, we are concerned that what coverage we do have might not be adequate. Neither Ms. Klein nor I are sure how long we can continue to expose ourselves and our families to these risks.

I would like to make second points. One is that day care is not a high risk business. From all that I have read, despite the few very highly publicized cases, child abuse is an extremely minimal part of anything connected with day care. Insurance companies have canceled policies despite the fact that they say they haven't kept adequate records on premiums and losses specifically for child care. They say they don't know what they've paid out their money for.

In New Jersey, in response to this crisis, Governor Keene's office conducted a random, statewide telephone survey of 147 of the State's licensed centers. And 81.5 percent had filed no claims whatsoever in the past 5 years. Of the 18.5 percent of programs which had made claims in this survey, most of those claims—82 percent—dealt with accidental injury; 7 percent with vehicular accidents; and only one claim, which is 3.7 percent of the total, involved child abuse or neglect. And that was settled without any payment whatsoever.

In addition, 67 percent of any claims were for less than $200. So while for the products liability cases there are huge awards and accusations against the tort system and the compensation for lawyers, that just doesn't relate to the issues involved in day care.

The second point that I want to make is that child abuse is not a real issue in this crisis. The American Humane Association estimates that 97 percent of reported sexual abuse cases occur in the home, not in a center; and that the abusers are parents or other relatives. In fact, centers can help prevent abuse rather than contribute to it. I have included an article to that effect, from the New Republic, December 9, 1985, issue.

Senator Kasten. Without objection, the article will be made part of your testimony.

Ms. Silverman. Fine. I had included it with the original papers which I sent to your committee.

As noted above, general liability policies such as ours do not now cover child abuse claims. Our policy was increased from $378 to $2,400, and now excludes any coverage for abuse. So you can see that there's a certain irony involved here, that we have less coverage for far more money.

I very much appreciated Senator Bumpers' astute comments on the precipitous nature of the premium rate increases. Day care is definitely not a part of this trend toward high judgment awards by juries.

In terms of suggestions for action, the reading that I have done and the people I have spoken with, have suggested several ways in which to proceed.

One, there could be a trial period of reasonably priced coverage by insurance companies, underwritten by the Government, to provide relief for the insurance industry if the number and dollar amounts of claims prove to be higher than the average for other insurable businesses. I'm talking about this only in terms of day care; I am not certain as to how this would translate into adequate coverage for businesses such the manufacturing companies represented were today. This is actually a form of reinsurance, which has been mentioned in the press.

Two, accurate statistics regarding actual claims and awards in the field of day care should be compiled or made public if they exist to determine if day care is, indeed, a high risk business. My suspicions are that they will find that it's not. The insurance industry claims that day care is a little bit less cost-effective for their companies to administer. I don't know if this is, in fact, true. But in terms of the awards, they are minimal.

Three, the insurance industry could be subject to antitrust laws. I gather from what's been said before that this is maybe heresy and I perhaps shouldn't even mention it, but I will. One of the articles that I have was written by Bob Hunter who is president of the National Insurance Consumer Organization, in Alexandria, VA. The article was in our local New Haven paper, and in it, he suggested repeal of the 1945 McCarran-Ferguson Act which allows insurance companies to fix prices.

Four, those several people I spoke with suggested that any regulation of the insurance industry should be at the State level. Personally, I'm reluctant to go along with that since many of the State insurance commissioners are from the insurance industry and they will return to it when their term is finished, thus placing the "fox in the henhouse." And I could be very wrong, but I had a sense that the gentleman from the Small Business Administration who spoke earlier—Mr. Sanders—was a bit of a "fox" himself, and I wondered why he was the spokesman for small businesses, but that's neither here nor there. [Laughter.]

Well, I'm sure that this committee will be exploring ways to reduce insurance costs generally. I do hope that the experience of our program, the Edith B. Jackson Child Care Program, which parallels countless others across the Nation, demonstrates the dire predicament posed by the escalating costs of insurance coverage for child care programs and how the continuation of these rampant increases threatens theirs and our very existence.

Thank you.

[The prepared statement of Ms. Silverman follows:]

February 20, 1986

TESTIMONY CONCERNING RISING INSURANCE RATES FOR A PRIVATE, NON-PROFIT FAMILY DAY CARE PROGRAM, THE EDITH B. JACKSON CHILD CARE PROGRAM, INC., NEW HAVEN, CONNECTICUT.

by Judy J. Silverman
and
Barbara F. Klein
Co-Directors

Given before the Senate Committee on Small Business

PROGRAM DESCRIPTION

The Edith B. Jackson Child Care Program (EBJ), located in New Haven Connecticut, is a family day care program serving approximately 45 children. The Center, which is organized as a not-for-profit corporation with its own Board of Directors, is one of six child care facilities affiliated with Yale University, and its program is notable in several respects.

EBJ operates seven day care homes, each with four children ranging in age from one to three and one half and one caregiver. The children may attend their day care home for half, three-quarters, or full days, five days a week.

To ensure a high level of care within each of the home settings, we have a three-part interview process for candidates, a four-day intensive training period for day care providers before each year begins as well as regular staff meetings, periodic visits to the day care homes and back-up arrangements for caregivers when they become ill. This is not the norm when it comes to family day care which more typically is loosely supervised by a state Department of Human Resources or Child Care Services.

Each child spends some time each week at the central Toddler

Center which is staffed with two trained teachers. The time varies with the age of the children. Two year olds come from two to three and three quarter hours a week; threes come five hours. The youngest children come periodically with their caregivers so that they will feel comfortable with the space and teachers in the event of substitution. The time at the Toddler Center provides for educational enrichment of the children.

In addition to this program for children under the age of three and one half, the Center also operates a Nursery Program at the Yale Child Study Center serving children three and one half to five years of age. It meets five days a week from 9:00 a.m. to 1:00 p.m.

It is the enrichment and support provided by the central program coupled with the benefits derived from care in a home setting which mark our program. Our Center has been called a "model program" educationally and has received national recognition. In terms of liability or injury it has never had a claim brought against it. Our design is supportive of families. It is also expensive and labor intensive. We have eleven teachers and day care providers serving the children affiliated with our program and will need two to three more staff members next year.

Tuition, which we struggle to keep as low as possible in the interests of the graduate students and University staff and faculty who use the program, is $508 per month for full time care. Like most day care facilities, tuition must sustain virtually all of our operating budget and, like most others, our salaries are lower than we would like for professionals with these responsibilities: a full time head teacher earns $10,500 for eleven months. Only by using every prudent cost saving initiative and introducing vigorous fund raising activities by the staff and parents has the program been able to continue its operation. Even so, our budget projected a deficit this year before notification of the insurance rate increase.

AVAILABILITY AND COST OF INSURANCE FOR EBJ

1. Last year, the program's carrier for general liability insurance cancelled our policy after informing us that their policy was available only for "Commercial Day Care Centers." While we were able to find another carrier after some search, the annual premium for March 1985 to March 1986 is $1,600; the same insurance coverage had cost us $378 the previous year. Next month the $1,600 charge will increase again to $2,400 per year. This is an increase of 634% in two years. It is important to note that this general liability policy, like those throughout the industry, does not provide any coverage for child abuse. Thus the risk to the insurance company has not increased (and indeed in excluding abuse, their risks have decreased), while the premiums programs are forced to pay have increased exponentially.

Our experience with huge increases in general liability insurance coverage appears to be the norm with programs similar to ours: when the policy of another Yale-affiliated center expired last fall the cost of the same coverage rose from $535 to $4,300 per year, even though that Center had never had a claim of any sort brought against it.

2. In addition, our umbrella policy was cancelled by the Hartford last fall. They based cancellation on the fact that they did not write our primary insurance. We could find no company that was willing to give us a quote for replacement coverage at any price.

Therefore our Board of Directors voted to eliminate it.

3. Workman's Compensation and non-owned automobile policies were also cancel'ed last fall for no ostensible reason. They were replaced at approximately the same cost with another carrier.

THE EFFECT ON OUR PROGRAM

Our ability to continue a program of excellence for the care of children is placed in severe jeopardy by the burden of these insurance rate increases. Moreover these rate increases have forced us to interrupt the important goals of putting in place a scholarship program for needy children and upgrading teachers' and caregivers' salaries.

In addition to the financial stress there are institutional and personal concerns due to our inability to find umbrella coverage. As directors we feel personally vulnerable now that our coverage is lessened. With no coverage for child abuse as well, we are concerned that what coverage we do have might not be adequate. Neither Ms. Klein nor I are sure how long we can continue to expose ourselves and our families to these risks.

SOME IMPORTANT POINTS

1. Day care is not a high-risk business.

    a. The insurance companies have cancelled policies despite the fact that they have not kept records on premiums and losses specifically for child care (see "Young Children" article, pg. 53) (see also "Exchange" p. 27)

b. New Jersey conducted a random statewide telephone survey of 8.4% (147) of the state's licensed centers. 81.5% had filed no claims within the past five years (see Special Reports, Day Care Information Service, Vol. 14, No. 23, 10/28/85; also Saugatuck Child Care letter to Rep. Miller, 5/85, p. 3)

c. Further, of the 18.5% of programs which made claims in the above survey, 85.2% dealt with accidental injury, 7.4% with vehicular accidents.
Note: Only one claim, (3.7% of the total) involved child abuse or neglect and it was settled without payment. In addition, 67% of any claims were for less than $200.

2. Child abuse is not a real issue in this crisis. The American Humane Association estimates that 97% of reported sexual abuse cases occur in the home, not in a center, and that the abusers are parents or other relatives. In fact, centers can help prevent abuse rather than contribute to it. (see New Republic, p. 16). And as noted above, general liability policies such as ours do not now cover child abuse claims.

SUGGESTIONS FOR ACTION:

1. There could be a a trial period of reasonably-priced coverage by insurance companies, underwritten by the government to provide relief for the insurance industry if the number and dollar amounts of

claims prove to be higher than the average for other insurable businesses. This is actually a form of "reinsurance," which has been mentioned in the press.

2. Accurate statistics regarding actual claims and awards in the field of day care should be compiled to determine if it is indeed a "high risk" business, (see "Exchange", p. 30).

3. The insurance industry could be subject to anti trust laws. See the New Haven Register article, written by the President and counsel of the National Insurance Consumer Organization.

4. Though several people I spoke with suggested that any regulation of the insurance industry should be at the state level, I am reluctant to go along with that since apparently many of the state Insurance Commissioners are from the insurance industry and will return to it when their term is finished, thus placing the "fox in the hen-house".

While I am sure this Committee will be exploring ways to reduce insurance costs generally, I do hope the experience of the Edith B. Jackson Child Care Program, which parallels countless others across the nation, demonstrates the dire predicament posed by the escalating costs of insurance coverage for child care programs and how the continuation of these rampant increases threatens their very existence.

DOCUMENTS MADE AVAILABLE TO THE COMMITTEE'S STAFF

Hunter, R. and Angoff, J. "Legal system not cause of insurance mess." Forum section of New Haven Register, Friday, February 7, 1986.

Saugatuck Child Care Services Incorporated, letter sent to Rep. George Miller, Chairman, Select Committee on Children, Youth and Families, signed by some 50 family day care providers and staff members, May 16, 1985.

(no listed author) "Special Reports" from Day Care Information Service. "The Insurance Crisis: An Update," Vol. 14, No. 23, October 28, 1985.

Strickland, J. and Neugebauer, R. 'Yes, We have No Insurance': A Bad Problem Getting Worse." Child Care Information Exchange, July 1985.

Wickenden, D. "Good-Bye Day Care." The New Republic, December 9, 1985.

(no listed author) "Public Policy Report, Liability Insurance Update."

Young Children, November 1985.

Saugatuck Child
Care Services
Incorporated

Parent Child Center
90 Hillspoint Road
Westport, CT 06880
203-227-1940

May 16, 1985

Honorable George Miller, Chairman
Select Committe on Children, Youth and Families
H2-385 House Office Building
Annex #2
Washington, D.C. 20515

Dear Representative Miller:

We are glad that you created the Select Committee on Children, Youth and Families. It's good to know that there is a forum for discussion of issues affecting the young and their families. We are writing you today about one such serious issue; we ask your thoughtful consideration and your help.

We are family day care providers and staff members of agencies that serve them all over the country. The term "family day care" describes child care in small groups in the (usually) state licensed home of an unrelated adult. People offering this service are called "family day care providers."

We come to you with a grave problem which may soon precipitate a desperate national crisis in child care. Unless we find a solution, soon, millions of working parents may be without the working hours care for their children which enables them to leave home to earn a living.

The issue is insurance to protect family day care providers in liability suits brought by parents whose children allegedly suffer from harm in a family day care home. Such suits are very rare. Nonetheless, affordable insurance should exist to protect providers from risking loss of their homes and possessions in order to pursue their livelihood.

Up until last fall, providers in every state had reasonable, adequate insurance options. There were family day care liability and medical payments policies available from several different companies. Liability limits ranged from $300,000 to 1,500,000 and premiums started at under $100 yearly and rose according to higher limits desired and extended coverages needed (i.e. coverage for carrying day care children in a provider's car, field trip coverage, etc.)

In the last few months, many insurance companies have stopped writing policies for family day care at reasonable cost. Some have cancelled on a Friday, effective the next Monday, making it impossible for a family day care provider to continue her job safely without interruption.

Child care centers are also suffering; this letter focuses on family day care because this is the field we know best. There is no doubt that centers are experiencing and will continue to experience exactly the same crisis. A response to one group will help resolve the problems of the other.

This situation exists all over the country. To give you an idea of its impact on an individual provider, on the children she cares for, and on her livelihood, we're attaching sketches of insurance problems of a few people here in Connecticut. These cases are replicated in nearly every state and are happening now.

Linda Ruocco, 50 Foote Street, Hamden, CT. 06517

This provider took out a family day care liability policy with Mission Insurance Company and was not billed for renewal at the end of the policy period. She was upset that her policy would have been allowed to lapse, leaving her no coverage, without a reminder.

She called Allstate, her Homeowners' carrier, to inquire about family day care insurance. Allstate's representative stated that his company did not offer such coverage and further indicated that her status as a family day care provider was a threat to her Homeowners' coverage. He explained that, now that Allstate knew she was doing family day care, it would exhaustively investigate any Homeowners' claim to establish whether it was caused by day care, in which case it would not be covered.

Blanche Hutton, 112 Kings Highway, North Haven, CT. 06473

She was notified this winter on the last day of the month that on the first of the next month her family day care insurance was cancelled. At the time she had a family day care liability policy written by the Mount Vernon Fire Insurance Company, as well as a very limited "Special Risk Accident Policy" through the Hartford Insurance Companies.

Ms. Hutton was able to persuade the Hartford to reinstate her Special Risk Policy, only, with its very minimal coverage, with specific, low ceilings for Accidents and Dismemberment.

Julie Manuel, 162 Cross Highway, Westport, CT 06880

In November 1984 this provider was notified that her family day care liability policy through th St. Paul Insurance Companies would not be renewed after its expiration date of December 1, less than two weeks away. To replace this coverage, for which she was paying $90 per year, the agent offered her the option of an individualized family day care policy, tailored to her needs, which would cost $300- $400 per year. She responded to their questionnaire with the information to use in designing her policy; they never got back to her.

Doris Horn, Route 6, Andover, CT. 06222

Starting out in family day care, she looked for months for adequate, affordable insurance, and could not find it. The best option she turned up was a Homeowners' Policy with United States Fidelity and Guaranty Company which offered a liability ceiling of $300,000, and would cover her only if she limited herself to just two day care children. Unable to make ends meet with such low enrollment, (she could expect to earn, with two, $150 a week at most,) she is still searching.

Peggy Ann Diaz, 6 Farm Creek Road, Rowayton, CT. 06853
This provider, with years of family day care experience and a full house (capacity of four), is now uninsured. She was notified in December that her coverage through the St. Paul Companies was cancelled as of January 1, 1985.

She objected fiercely and the company extended her coverage for one more quarter, ending April 1, 1985. Her research has netted her two unsatisfactory choices. The first was a day care liability policy with a limit of $500,000 for $373.20 per year. The second, for $327, consisted of a liability policy with a ceiling of $300,000 but including no accident or dismemberment coverage or medical payments for accidents to herself or her family.

The experience of these licensed, responsible family day care providers is typical. None of them has ever submitted a claim under her family day care coverage. None has ever been sued -- and this is the norm. The bugaboo of litigation-happy parents suing providers for all they are worth for the least little scratch is only that -- a totally unjustified fear.

The relationship between most parents and most family day care providers is quite the opposite. Parents have entrusted their most precious possession to their provider; they have chosen her because they trust her and they will continue to trust her. Without her, they cannot work. It is in parents' interest to support her, not to threaten her.

One incident will illustrate the quality of most provider-parent relationships. Anne Gelderman, 7 Harstrom Place, Rowayton, CT. 06853, was carrying day care children in her car when she was struck by another vehicle and her own car was totalled. The children were properly restrained in car seats and only one was possibly injured; he had a scrape on the head which may have resulted from the collision. His parents kept him home from care for one day, to observe him, but insisted on paying the provider for that day anyway. Their trust in and show of support for their provider exemplifies the rule rather than the exception.

What seems to have happened is progressive panic on the part of insurance companies as they watched allegations of child abuse in day care pour out of the media. Recently there have been reports of a few large suits for bodily injury or child abuse, not suprising in a group of two million practitioners; such occurrences are, however, rare.

Insurance companies have a right to protect themselves. We don't question that. Our concern is that family day care providers have the same right. Most especially, children in family day care need to be protected in the event of a one-in-a-million accident.

Right now, the private sector is doing nothing to address this problem and much to exacerbate it. We need your help in making it public and suggesting what government can do. At the State level, some of the possibilities are:
1) laws requiring that family day care providers be insured,
2) State Insurance Commission action to see that appropriate and competitive policies exist for that purpose,
3) formation of Special Risk Pools with the State as the insurer of last resort.

At the Federal level, we know we need you to direct attention to the issue. Eventually this situation will seriously affect employment rates nationally if providers, having lost insurance coverage, give up day care and parents have to stay home to care for their own children. We can anticipate the need for AFDC escalating as parents who were self-supporting lose income and become needy. Food Stamps and other entitlement programs can be expected to undergo huge increases. In other words, the loss of insurance for all family day care providers can be very expensive for all taxpayers. (Not to mention the loss of tax revenues from providers themselves, who pay taxes on their self-employment income.)

What are other remedies that Federal or State legislators can word toward? We very much need your thoughts as well as your words and deeds!

Enclosed for your information is material on a national survey being made of centers and well as day care homes, by the Child Care Action Campaign. With specific data on insurance cancellations and past claims, we hope to be able to influence governmental bodies, actuaries, and insurance companies.

This letter is signed by some fifty family day care providers and staff members of agencies working with providers, who met in caucus in Atlanta in April to discuss our situation. All of the signatories are ready with more information about insurance difficulties in their own regions, and would be eager to respond to any questions from you or your staff. *

Thank you for your attention. We will keep you up to date on events.

Sincerely,

Ginny Shaw
Ginny Shaw
Coordinator
Patsy Kohout
Patsy Kohout
Assistant Coordinator

Saugatuck Outreach Nutrition
90 Hillspoint Road
Westport, CT. 06880

Diane Adams, Assistant Director
Dane County 4-C
3200 Monroe STreet
Madison, WI 53711

Susan Adger
Early Childhood Consultant
Project Playpen, Inc.
4140 - 49th Street North
St. Petersburg, FL 33709

* To limit paper work, the list is not included here.

Child Care Informat.

"Yes, We Have No Insurance": A Bad Problem Getting Worse

by Jim Strickland and Roger Neugebauer

Just when you thought it was safe to come back to the center.... You'd endured the recession, you'd survived Reagonomics, you'd overcome the hepatitus scare, and you'd weathered the sex abuse storm... and then your insurance was canceled.

If it's any consolation, you are not alone. Across the land, insurance companies have been canceling or radically altering child care centers' liability insurance policies faster than you can say "You're in good hands with Allstate."

Since the first article on the insurance crisis appeared in the March, 1985, issue of **Exchange**, the Child Care Action Campaign and **Exchange** have been closely monitoring developments. We mailed out questionnaires to 1200 child care providers; and we consulted with leaders in the insurance industry. Based on our research to date, here is a capsule summary of what we see happening:

- Good news—Forty-eight percent of the centers responding to the survey reported ***no significant problem*** with their insurance coverage.
- Bad news—Forty percent of those reporting *no problems* are insured by companies which have now decided to discontinue insuring child care centers or to make drastic changes in their policies.
- Bad news—Seventeen percent of the centers had their insurance canceled or not renewed.
- Good news—Most of those who lost their insurance have been able to secure coverage elsewhere.

Jim Strickland is executive director of Child, Inc., a multi-site Head Start/ day care organization in Austin, Texas.

- **Bad news**—Cancellation of policies of family day care providers appears to be more widespread. Once home providers are cancelled, they also have a harder time securing new coverage.

- **Bad news**—Thirty-six percent of the centers have had their rates increased anywhere from 100 percent to 500 percent..We project that in the next 12 to 18 months child care centers nationwide will be faced with absorbing rate increases approaching \$30 million.

- **Bad news**—Most insurance experts agree that the problem is going to become more severe before it gets better. A second wave of cancellations starting in August may even be more substantial than the first wave.

So what are the implications for providers of child care services of this less than encouraging news? To fully understand the implications, it is helpful to first take a quick look at how the insurance industry works (or fails to work), and how child care fits into this picture.

Insurance Industry Myths

Hold on to your seats—we are about to dispel some commonly held myths about insurance. The first is that insurance companies are in the business of selling insurance; the second is that insurance companies always base their decisions on statistical information; and the third is that the big suits against the corporate giants won't affect you.

If you believed that insurance companies were in the business of selling insurance, we have a bridge in Brooklyn that we would like to sell you. Insurance companies make their money by *investing*. Selling insurance is just a *sideline*. It's an important sideline because it produces a unique *by-product*—money. Money which can be invested. If investment capital was a by-product of the meat packing business, the New York Stock Exchange might be overrun with names like Metropolitan Weiner and Mutual of Lambchops.

That is a gross oversimplification, of course, but it should get you to think in the proper terms. What this means is that when interest rates are high, so that insurance companies can earn high yields with the money they invest, they are not so concerned about the profit margins on the policies they sell. When interest rates fall, insurance companies become increasingly nervous about their profit margins.

One reason this current crisis comes as such a shock is that we have just been through a *soft cycle*—interest rates were high and insurance premiums were low. Everyone wanted to sell you insurance. As a result, insurance premiums for nonprofit corporations, for example, actually dropped by 40 percent from 1979 to 1983 (**The Nonprofit World Report**, March/April, 1985).

To make matters worse, recent years have witnessed skyrocketing insurance claims, soaring legal fees (win or lose), and astronomical rewards. The bottom line is that insurance companies have been taking a beating lately, i.e., the *Rock* has been caught between a rock and a hard place. One top insurance executive informed us that the insurance industry has lost more in the last 4 years than it had earned in the previous 20. Another set industry losses during this period at \$21 billion.

Any industry that can sustain a \$21 billion loss and keep on ticking isn't likely to generate a great deal of sympathy. Yet it isn't sympathy that they are looking for. If they want anything right now it's probably *out*—out from under low-profit policies. As a result, we are now experiencing a *hard cycle* during which insurers typically increase their rates, red line *risky* lines of coverage, place more restrictions on policies, increase deductibles, reduce coverage amounts, and employ stricter underwriting requirements.

Implications for Child Care

Who would have thought that the rise and fall of the prime rate, or the Union Carbide disaster in India, would impact the Hippety-Hop Day Care Center down the street? But factors such as these are putting pressure on insurance companies, and child care centers and family day care homes are feeling the pain.

If it is any consolation, child care centers are not being singled out for harsh treatment. This is a major crisis; hospitals, health centers, school systems, local governments, and many forms of business are caught in this hard cycle as well. In fact, the Insurance Services Organization projects that between 1985 and 1987 the demand for insurance will exceed the supply of available insurance by \$60 billion (**San Francisco Chronicle**, June 3, 1985).

Thus it would appear that child care has been relegated to this large pool of low-profit or high-risk businesses. Yet there is some question as to whether child care deserves to be viewed as a high-risk business. If it has been a ***high risk***, apparently it is one that virtually went unnoticed by the insurance trade journals. A computer search of articles in insurance journals for the past five years produced *none* citing child care as a particularly *risky* or high-loss area.

Our own survey indicates virtually no high dollar claims being filed; and interviews with numerous insurance agencies readily confirmed that. Liability claims from child care and preschools were rare; and when they did occur, the settlements were not especially large—certainly not in the million dollar range cited by some companies as their justification for pulling out or escalating rates.

No one really knows what the loss statistics are for child care liability. Many insurance companies are not willing to release this information which they consider proprietary. The companies which are releasing the information tend to lump liability losses with other losses. This has added to the confusion. For example, St. Pauls reports a net loss of over \$4 million on its child care policies for 1984, but can't differentiate common accident claims (by far the most common type) from liability claims.

Furthermore, in our admittedly unscientific survey, we found no apparent relationship between centers' claim experience and insurance

Table 1—Insurance Company Scorecard

Category	Description	Company	Notes
Companies Getting Out	Companies reported by one or more centers surveyed to have cancelled or not renewed liability policies. These companies may not have dropped out of the child care field completely. Nor does the list include all companies that are no longer in the business—only those reported in our random sample.	Aetna	Except in California under PACE plan
		American States	
		Atlanta Mutual	
		Hartford Group	Based on very late reports
		IDA	
		INA	Except under NAEYC Safety Group plan
		St Pauls	
		Western Life	
		USF & G	
Companies Staying In	Companies still reported to be writing or renewing liability policies for child care centers. Many, however, are doing so at much higher rates, or with major exclusions. Many of these, also, are not accepting any new policies, i.e. they are only serving their current customers. Inclusion in this category should not be construed as an endorsement by **Exchange**—check with your agent for current policies and credentials.	American Reliance	
		Brotherhood Mutual	Primarily church-related centers
		Church Mutual	Primarily church-related centers
		Cincinnati	
		Commercial Union	
		Farm Bureau	
		Firemens Fund	With substantial rate increases
		Franklin Mutual	With substantial rate increases
		Great American	Writing for First Trust risk pool
		Maryland Casualty	
		Mount Vernon	With 500% increase in rates
		Mission	Writing for BMF—may stop in August
		Nationwide	
		New Hampshire	
		Preferred Risk	With substantial rate increases
		Safeco	Reportedly not taking new policies
		State Farm	With substantial rate increases
		Travelers	
		Uniguard	With 150% increase in rates

companies' actions. Sixty percent of those centers which had filed claims against their policies reported no adverse action by their insurers. On the other hand, the great majority of the centers which lost their liability coverage had *never* even filed a claim.

A Period of Uncertainty

Whether insurance companies' reluctance to insure child care centers is based on sound actuarial *loss trending* or upon an emotional reaction to headlines, it appears that it will be many months before any sense of stability returns. Right now you need a scorecard to keep track of who is in and who is out (let alone who is on first base). Even that won't always help. For example, in the survey we found several instances where Company A would drop a center and Company B would agree to cover them; then Company B would drop a center and then Company A would write that center a policy.

It is clear that many companies have already opted out of child care and that many that continue to serve the field are seriously considering getting out. Depending on the region of the country (some areas are more lawsuit prone than others), the history of the applicant, the ability and temperament of the insurance agent, or the time of day, companies are changing their minds almost by the minute.

Who's In and Who's Out

In reviewing the survey results, we've discovered that some companies don't want your business at any price; some might be coerced into taking it, but will charge you handsomely for the privilege; som may accept your business without knowing it; and others might just take your money and give you the business.

- **The "not at any price" companies.** These are typically the companies who entered the marke in the '70s, when prices were soft, with a line of *multi-peril* policies—"We'll sell you most of your insuran in one package and at a substanti discount." Unfortunately, their ent was based more on speculation th the calm considered work of actuari

Now that interest rates are do and losses are up, easy times are ov and these companies feel no oblig tion at all to maintain the relations Perhaps it wouldn't be so hard to take if they would have said from the beginning that it was *just a fling*—that *it wouldn't last*. Now that the affair is over, we're left with the kids (about 1,800,000 of them) and no hope of child support.

- **The "if the price is right" companies.** This category includes companies known as *excess and surplus lines* and a few other companies which were writing multi-peril policies and are now adjusting these policies and rates to be more in line with reality. This is probably the category in which you'll find the most confusion; it's changing almost daily as insurance companies compete to buy steadily decreasing *reinsurance coverage*.

Reinsurance is a whole other type of insurance, but for now it is sufficient to know that insurance companies must buy it to protect themselves against catastrophic losses. It's an essential element to the insurance business. There is not enough of it available. It's going to companies which can write the types of businesses which can pay the highest premiums and produce the lowest risks. Child care might not be the highest risk, but neither is it the lowest; *and* it is not likely to be able to pay as high of premiums as the trucking industry, medical profession, and metropolitan areas which are also in an insurance crisis.

Because of the limited ability of child care centers to pay high premiums, they are generally not in a strong bargaining position when it comes to maintaining coverage. As Orpha Grimsrud of Western Life Insurance Company explained, "Day care policies are dinky little policies. They've been a pain in our side for a long time" (**Seattle Times**, May 23, 1985).

The *more is less* principle seems to be in effect here. Not only are centers paying dramatically more than before for this insurance, but they are also purchasing considerably less coverage. Increasing numbers of insurers are writing child abuse exclusions into their polices. Most are dropping maximum liability levels down from $1 million or $500,000 to $250,000 or less. If you are able to purchase extra coverage to make up for policy limit reductions and exclusions, the total cost may be as much as 10 to 12 times your old premium.

- **The "hanging in there" companies.** There are still some companies that are maintaining their child care coverage, and are doing so without dramatic rate increases. This category is the most fragile. It includes some companies who are writing child care coverage and probably don't know it. It is entirely possible that centers so insured may slip by unnoticed—*until a claim is filed*.

Another subcategory includes those companies which don't consider child care coverage to be a problem yet. An unfortunate, but typical, scenario is that Centers A and B will lose their coverage; their directors will call the director of Center C to find out who is insuring that center. Then when Directors A and B call the insurer of C, this causes the insurer to panic and he proceeds to cancel out Center C.

- **The "give you the business" companies.** During a hard cycle, companies having a problem finding insurance are typically preyed upon by unscrupulous and insolvent companies—companies that will gladly take your money in return for a piece of paper, but which will never be able or inclined to pay your claims. Our survey failed to flag any of these companies, but the National Association of Insurance Commissioners has recently cited as many as 300 financially unstable property and casualty carriers (**Boardroom Reports**, February 15, 1985).

The Search for Solutions

When the insurance crisis first came to our attention, we expected to find simple solutions. "Let's just call up the right people and have them tell us what to do." Well, we called up the *right* people, and they didn't have any answers either.

So it appears that there are no obvious quick fixes. However, a number of local, state, and national organizations have been working

Table 2
Organizations Exploring Solutions

American Montessori Society.
Virginia Lee (212) 924-3209.

Working with insurance brokers to develop group liability policy for Montessori schools.

Child Care Action Campaign.
Jim Strickland (512) 451-7361 or Elinor Guggenheimer (212) 334-9595.

Bringing together leaders in child care and insurance industries to try to develop some long range solutions.

Child Care Law Center.
Carol Stevenson (415) 495-5498.

Coordinating efforts of providers and politicians to arrive at a solution for the state of California.

First Trust.
(800) 323-5157

Managers of the Non Profit Risk Pool, a group insurance plan for non profit organizations.

Insurance Information Institute.
Jeff Palca (212) 669-9238.

Information clearinghouse for insurance industry. Can supply names of key insurance industry contacts for those working toward solutions at the state level.

MarketDyne International.
(800) 523-2710.

Developers of the revised NAEYC group insurance plan. To be contacted for coverage call 800 number above.

Michigan Department of Social Services. Bill Hankins (517) 373-0356.

Coordinating efforts of providers and insurers to arrive at a state solution.

Saugatuck Child Care Services.
Ginny Shaw (203) 227-1940.

Leading efforts of family day care advocates around the country lobbying for insurance relief for family day care providers.

United Way of America.
Pat McClenie (703) 836-7100.

Serving as a clearinghouse for local United Way agencies concerned with providers' insurance problems.

very actively to explore a number of emerging solutions. The following is a brief description of some of these options:

- **Experienced-based rates.** As was indicated earlier, many of the radical decisions being made today on child care policies are being based more on emotion than fact. If sound actuarial statistics could be compiled and publicized, insurance companies would have a rational basis for negotiating out coverages and rates. This approach has merit, but it clearly will require a great deal of research. Therefore, it is not a short-term solution.

- **Group insurance policies.** Insurance companies are less reluctant to offer insurance when they can balance their risks against a large pool of premiums. By offering coverage through a creditable organization, the insurance company can also rely to some extent upon the sponsoring organization to set some quality standards which must be met to qualify for the plan.

One problem with this approach is that, because of the extreme diversity that exists among programs, no one organization can set standards that all centers will be willing or able to meet. What is needed is not one single group plan but a variety of plans to match the varying styles of operation.

There does appear to be some success in this area. After months of negotiation, the National Association for the Education of Young Children (NAEYC), has convinced MarketDyne International to offer coverage to NAEYC members through the Insurance Corporation of North America (INA). The Professional Association of Childhood Education (PACE) in California provides coverage for its members through Aetna. The American Montessori Society is currently negotiating with several companies to establish a group plan for its members.

- **Self-insurance groups.** Under this plan a large number of centers would band together and insure themselves. In the insurance world this is known as forming a *captive*.

This proposal has created a lot of excitement. After all, the group controls the rates and perhaps could benefit from the investment capital. Doctors, lawyers, and the construction industry have done it. The problem is that it requires that we have a group which serves at least 200,000 children before it becomes feasible.

Also, this plan would require that all involved meet very exact, preset standards; and it would also be subject to the problems with reinsurance (see discussion above). At best, this is a mid-range solution. It would require too much work to be accomplished immediately and too much risk to stay with for too many years. (Ironically, that's exactly what most insurance companies have decided.)

- **Assigned risk pools.** Advocates in several states (such as California and Washington) are working with their insurance commissioners to investigate the possibility of forcing insurance companies to set up insurance pools for child care centers (like assigned risk pools that now are set up for poor drivers). The problems are obvious—all child care is not poor, and that which is shouldn't be insured anyway. Also, states can force companies to sell insurance, but they can't force the companies to stay in their state. Companies are already considering pulling out of some states; this might be the only push they would need.

In a similar vein, there is some interest stirring at the federal level in exploring solutions. For example, the General Accounting Office has begun some preliminary investigations. Also, members of Congress, such as Representative George Miller from California, are looking into options similar to federal flood insurance and riot reinsurance, where the federal government stepped in where insurance companies feared to tread.

As can be seen, each of these potential solutions has its strengths and its weaknesses. Probably no single solution will solve the entire problem, so it is encouraging that many groups are working actively on many fronts.

On June 27, the Child Care Action Campaign will be meeting with Henry Greenberg of the American International Group, along with other key insurance and child care representatives. This meeting should serve to start the ball rolling on developing some viable long term solutions.

What You Can Do Now

Your immediate concern is obviously maintaining insurance coverage until stability returns. Some short-term steps may be helpful:

- Even if you don't think you have a problem, do yourself the favor of checking out your renewal prospects with your insurance agent. You may be covered by a company that has decided to bail out. We have already heard too many horror stories of centers not finding out until their renewal date was upon them that they were not being renewed.

- Find a good insurance agent or broker and put him to work. Be sure your representative has the qualifications, interest, and time to evaluate your risks and to present your needs accurately to underwriters.

The financial condition of insurance companies is changing so rapidly today that you can no longer rely on rating services to reflect the actual condition of companies. You must use your agent to steer you away from unsound or unscrupulous insurance companies (**Boardroom Reports**, February 15, 1985).

- Have your agent help you review your center's safety procedures and potential high-risk features of your program or facility. By narrowing your exposure to risk, you can make your center a much more insurable entity.

- Look for ways to offset rate increases. Are there deductibles that could be increased? Are there coverages that you now carry that you could drop since you could afford bear the cost of potential losses? Some coverages that you bought when insurance was cheap may no longer be a good deal.

- Keep informed. This is a volatile situation. Be alert to changing conditions and new opportunities.

SPECIAL REPORTS
DAY CARE INFORMATION SERVICE'S IN-DEPTH REPORT ON TIMELY TOPICS

Vol. 14 No. 23 October 28, 1985

THE INSURANCE CRISIS: AN UPDATE

Push to make coverage available gets limited results

Day care groups, insurance brokers, underwriters and government officials continue to grapple with the lack of affordable insurance for day care programs that we reported in our 5/27/85 Special Report. "We are still getting 200 calls a week from providers at wit's end," says Deborah Phillips of the National Assn. for the Education of Young Children (NAEYC). This follow-up report looks at some steps being taken around the country to try to resolve the problem.

● NATIONAL EFFORTS FLOUNDERING -- MOST PROGRESS AT STATE LEVEL

Efforts by national groups and brokers to get nationwide policies from major underwriters have met little success thus far. NAEYC's new policy with CIGNA (Day Care USA 7/22/85) won't cover family day care, Head Start or other programs with significant numbers of publicly paid clients, programs operating less than 25 hrs./wk. and programs with staff/child ratios greater than 3-1 for children under two. NAEYC and California's Lora Rica Insurance Agency have separately been pushing for broader standards from CIGNA for months and keep getting the run-around, they say.

CIGNA is "studying it state by state," a company official tells us. It will offer insurance more readily in states that enforce the strictest standards, he says. Covering family day care is at least six months away, says the official, who asked not to be identified. He says the company hasn't even been able to gather detailed regulatory data from more than 10 states, and family day care is harder to insure than centers, because safety in private homes is harder to standardize. "Sex abuse is not the issue," he says. "Life safety standards are." The company is rejecting applications from centers that don't meet its health and safety standards, like maintaining automatic sprinkler systems, he adds. CIGNA is closer to broadening coverage to part-time and government funded centers than it is to offering a family day care policy, he says.

The Child Care Action Campaign (CCAC) and other day care advocates are pushing for a national policy through broker Marsh & McLennan. Several national carriers have rebuffed the broker. But the company says it has seriously interested a large underwriter in covering homes and centers and insuring for child abuse and neglect. The carrier refuses to identify itself until it makes a commitment. A decision could come any day, or could be months away, sources tell us. The company is large and reliable, says CCAC'S Jim Strickland. It plans to cover all classes of regulated providers, from centers to family day care and Head Start. The program might not start in all parts of the country at once, Strickland says.

Rates will vary depending on local claims data, licensing standards and enforcement. They could be prohibitively expensive, some fear. The unidentified company, negotiating through Marsh & McLennan or anonymously with CCAC by telephone, originally offered rates of about $175/child/yr. for licensed family day care for a claims-made policy, says Maribeth Oakes, family day care advocate for the Children's Foundation. The carrier came down to about $70, still too high for providers -- most couldn't afford more than $30-$40, she says.

Form coalitions with other groups "in the same boat," like nurse midwives, Phillips advises. Get employers on your side -- let them know that the lack of affordable insurance threatens their employee's child care arrangements and therefore employee productivity, she counseled an insurance forum at the recent annual conference of the National Black Child Development Institute. Share concerns with state insurance commissioners, she advised a House panel.

After a few hearings exploring the subject, Congress isn't prepared to mandate a national legislative solution. Some statewide efforts have met with more success than national ones. Their stories follow.

● STOPPING CANCELLATIONS BY GOVERNOR'S DECREE

New Jersey Gov. Thomas Kean decreed an emergency, forbidding insurance companies in the state from canceling day care insurance for 60 days starting Sept. 17. Insurers must renew for an equal length of time any contracts expiring in the period -- i.e., a six month contract must be renewed for another six months. Companies can raise rates upon renewal, though -- the state lacks authority to govern rates. The state sent notices to all licensed centers advising them of the ruling and also issued a press release. The notice included an address in the state Insurance Dept. to write to with comments or suggestions for further action.

Insurance companies can get exemptions only if they persuade the insurance commissioner that they can't afford to continue or want to cease operating in the state. Continuing the ruling over the long run could lead some underwriters to want to get out of the state, officials concede.

The state government also put together some hard data -- that insurance companies say they lacked -- to show that day care is a reasonable-risk business. The licensing bureau conducted a random statewide telephone survey of 8.4% (147) of the state's licensed centers, reports Nick Scalera, assistant director, Div. of Youth and Family Services. Eleven, or 7.5%, reported cancellations at the end of their policies. All found replacements, usually with other carriers, Scalera told the Virginia Commonwealth University Licensing Institute in Richmond VA. "That told us something we were not reading in newspaper clips," he said. 81.5% said they filed no claims within the past five years; 11.6% cited one claim. Less than 1% filed three. with the rest filing two.

"Child abuse was being blown out of proportion," he documented. 83.2% of claims dealt with accidental injury, 7.4% vehicular accidents. Only one claim -- 3.7% of the total -- involved child abuse or neglect, and it was settled without payment, Scalera reported. Regarding costs of claims, 67% were for less than $200.

Scalera brought the data (and figures showing less than 1/10th of 1% of abuse and neglect substantiations took place in licensed centers) to the state Insurance Dept. The division also sent its first Day Care Insurance Alert to all licensed centers, reporting the survey results and that "we were aware of the problem and need their help to solve it. It was two pages, because we know they don't read anything longer," Scalera said. The alert gave names and numbers in the insurance department to call in case of problems.

A second alert mailed to centers told them about an out-of-state company willing to write policies for New Jersey centers.

● PROBLEM IS UNIVERSAL, SURVEYS SHOW

While it's hard to get, most states require at least some providers to carry insurance, national surveys show. A survey of state governments conducted over the summer by the Social Services Committee of the National Council of State Human Service Administrators of the American Public Welfare Assn. (APWA) found that 30 of the 40 states responding (including the District of Columbia, Puerto Rico and Guam) put some requirements on providers. A similar survey by the Child Care Law Center (CCLC) found insurance requirements in 20 of 30 responding states. According to the surveys:

- At least nine states require insurance only for providers taking government-paid clients; 11 require insurance only for centers, APWA found. California requires insurance for family day care centers only, APWA reports, though California centers must maintain "sufficient financial resources to retain standards of service," CCLC says.

- Specific amounts of insurance are required only by 13 states. Specifications range from flat figures, such as Florida's $100,000/center, to numbers per child or incident, as Wisconsin's $25,000/person and $75,000/occurrence general liability. Indiana, Montana and Tennessee require only "sufficient" or "adequate" coverage. Nevada doesn't specify figures, but it indicated some of its localities do.

- Rates are increasing for centers and homes, 34 states told APWA. Rate increases range from 10% to 400%. Illinois reported a problem for centers only, and Delaware said it "seems to be harder for centers to obtain reasonably priced insurance." Louisiana reported that, while center rates are increasing, family day care "providers seem to be having the most difficult time getting or keeping insurance."

- Providers have ceased operating because of a lack of insurance in at least nine states, their governments told APWA: California; Texas; Wisconsin; North Dakota; Maryland; family day care in Massachusetts, Nevada and Hawaii; one preschool in Kansas. Most states indicated they didn't know if programs closed for lack of insurance. Several said some providers were on the verge of closing or were operating uninsured. Arkansas reported that insurance problems factored into decisions to close but weren't solely responsible. Hawaii reported that some providers ceased some activities, such as transportation, because of insurance problems. One Hawaii program reportedly "gave up its van when" insurance jumped from $1,500 to $6,000.

- Arkansas found that the problem is less acute for church-related programs than for other providers. The state can't explain why, says Kathy Stegall, Child Development Unit staff manager.

- A few states require insurance only for transportation for some providers, the surveys report. Illinois requires family day care to be insured only for vehicles, APWA reports, while Michigan told CCLC only transportation must be insured.

- Idaho doesn't require provider insurance, but the city of Boise does.

● OTHER DEVELOPMENTS

In other insurance-related developments:

● The threat of legislation was all it took to spur California insurance underwriters to seek a solution. State Sen. John Seymour introduced a bill that would have required all liability insurance companies in the state to participate in a joint underwriting authority to cover day care programs. Seymour set aside the legislation when 26 underwriters agreed to form a voluntary assistance plan. Providers who show they've been rejected by two carriers can approach the group, which randomly assigns three members to bid for the provider's insurance. Seymour indicated that, if the plan doesn't work, he'll push the bill.

● The Washington state insurance commissioner forbade insurance companies from denying, canceling or terminating homeowners' insurance on the grounds that day care is practiced in the home. Underwriters could limit or exclude liability for the day care business, though. California's legislature passed a bill with a similar provision in September. The bill requires underwriters to present annual reports to show whether they're losing money in day care insurance.

● Maryland's insurance commissioner is preparing a voluntary marketing assistance plan (MAP), in which the office will match up providers with underwriters willing to offer insurance. The program would have been up by now if the commissioner hadn't been preoccupied with the state's savings and loan crisis, one staffer suggests. The state needs a formal MAP, because an informal telephone poll didn't work. Underwriters said by phone that they were offering insurance, but they later turned down providers referred to them. Gov. Harry Hughes wants to announce the program personally, we're told.

● An American Insurance Assn. working group on day care hopes to establish a position paper by the end of the year. The paper will cover misunderstanding between insurance and day care industries and may contain recommendations for insurers, group members tell us.

● Minnesota Gov. Rudy Perpich and several other governors asked the National Governors Assn. (NGA) to explore the issue. NGA will probably put out an information packet for governors but doesn't plan any research on the matter, says Roy Simon, senior staff associate for income security and social services of NGA's Committee on Human Resources.

Day Care Information Service
4550 Montgomery Ave., Suite 700 N ● Bethesda, MD 20814
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PUBLIC POLICY REPORT

Liability Insurance Update

"I've never had an insurance claim, but my policy was just canceled."

"I'm calling everywhere for insurance, but in the meantime I need proof of a policy to renew my lease."

"I've been setting aside funds for the Center Accreditation Project, but now I need to use them to cover my increased insurance premiums."

"I can't believe I have to choose between closing my program or operating without insurance."

"This is a nightmare!"

Sound familiar? We receive 200 calls like this every week at NAEYC Headquarters. You are not alone, but this provides meager comfort as you grapple with your insurance problems.

Your most important task is to remain informed, assertive, and determined to find a solution. It is very easy to begin to feel helpless and defeated. The recommendations here will help you fight these feelings. They will also tangibly contribute to your efforts, as well as NAEYC's efforts, to make affordable, dependable insurance coverage available for child care programs.

What is happening?

The current insurance crisis has four parts.

Access: Insurance for programs is being canceled midterm or not renewed, and replacement policies are exceedingly difficult to find *at any price.*

Affordability: Programs that do find insurance are assessed rate increases anywhere from 100% to 600%; 300% to 400% increases seem to be the norm.

Predictability: Nonrenewals and rate hikes affect programs regardless of their claims history, quality, and years of operation. Moreover, programs often are given one month's notice or less.

Coverage: Almost all companies that still carry child care programs exclude child abuse and sexual molestation from coverage. Many other new exclusions and eligibility criteria are also being applied.

Why is this happening?

The underlying reasons for the current insurance crisis are primarily economic. For the past several years, the insurance industry has benefited from high interest rates that produced high returns on their investments. Today, that situation has reversed, leading insurers to scrutinize their policies in an effort to prevent major financial losses. The result has been an almost complete withdrawal from several areas of coverage, including nurse midwives, municipalities, obstetricians, and child care providers.

Child care is on this list of presumably risky (and therefore unprofitable for the insurance industry) businesses even though insurance companies have not kept records on premiums and losses specifically for child care. The sensationalistic headlines about child abuse in child care settings have had a profound effect on insurance companies' perceptions of the risks involved in providing child care. Given the phenomenal number of lawsuits filed in our society, the combined effect of these factors has been the insurance industries' extreme hesitation to write child care policies.

What is the result?

When faced with no insurance carrier or budget-breaking rate increases, programs must make some difficult trade-offs, depending on the income bracket of the families served and state licensing requirements.

Some programs may decide to operate without insurance. This is not only unwise, but also is illegal in states that require licensed programs to carry liability insurance.

Programs serving parents who are able and willing to pay more for their child care may pass the premium hikes on to the parents.

Programs that rely on government subsidies or that serve low-income families have no option except to cut program quality or to close down. This will seriously reduce the availability of licensed child care for low-income families.

What is being done?

Although child care is not the only business characterized as risky by the insurance industry, our profession has received by far the greatest publicity and concern. Media coverage has been extensive and highly positive.

Some states, such as California, have drafted legislative responses to the child care insurance shortage. The California legislation prompted insurers in that state to establish a voluntary alternative to government intervention—a Marketing Assistance Plan. At the federal level, U.S. Representative George Miller has held two hearings on the issue and has surveyed each states' insurance commissioner. Several other members of Congress are also tracking the situation and considering federal legislative responses.

Within the insurance industry there are a few good faith efforts to develop a solution voluntarily without government intervention. NAEYC is working with other national child care organizations to facilitate these efforts by providing accurate information about child care.

In many states, regional and statewide child care coalitions have been formed to develop strategies to document, cope with, and remedy the insurance crisis. In Maryland, for example, the state Office for Children and Youth and the Maryland Committee for Children have formed an insurance task force. In other states, such as Colorado, Pennsylvania, and Florida, provider groups have formed coalitions around this issue.

What can I do?

Don't panic! There are many constructive steps you can take.

1. Find out what your insurance agent and carrier know about child care. Often they have inaccurate or incomplete information and make decisions based on these misperceptions. Be prepared to educate your insurers about the professional delivery of child care.

Think of this task as your way to replace media-driven concerns about child care with more positive impressions. To be effective, offer a business-like, professional documentation of facts. This not only serves to educate, but also affirms your image as a professional for whom insurance is a necessary part of doing business.

2. Document your program's entire insurance history. Note the name of your carrier, the type and extent of coverage, the premiums, and any claims filed and paid. In addition, document any recent changes in your insurance policy and the measures you have taken to obtain affordable insurance with adequate coverage.

3. Adopt and document measures to reduce your level of risk.

- Use systematic and careful screening methods to hire employees. Set up probationary periods for new staff.
- Keep your staff-child ratios as high as possible. Draft an emergency plan that assigns the maximum number of staff to children possible.
- Prepare written operating procedures, policies, and personnel requirements.
- Ensure that all staff participate in training programs, such as sessions on first-aid and child abuse prevention.
- Allow parent visitation at any time.
- Develop a stringent system to supervise all staff.
- Document how the physical safety of children is protected in your program: staff first aid training, collaboration with medical practitioners, and safety practices for field trips.

4. Inform your insurance agent/company about your experiences, options, and likely responses at every step from your first receipt of a nonrenewal or rate increase. Send them copies of all letters you write (see #6). Send them a copy of your program's insurance history and regular updates to reflect your efforts to obtain insurance.

5. Before you call every insurance company in the phone book, first call your insurance commissioner (usually in a state office of insurance). This office should maintain current information on the companies that still write child care policies in your state. Keep track of every insurance company you contact, and their responses to your request for insurance, including anticipated and actual delays between initial contact and an effective policy.

6. Write a business letter describing your predicament to your state insurance commissioner. Document your child care license or explain why you are not licensed (e.g., the state does not license part-day programs), your insurance history, and your program quality (see #3). Send copies of this letter to your state and federal government representatives, and your state or local child care licensing office.

7. Meet regularly with parents of children in your program. They need to remain informed about the problem and to be part of the decision process as a solution is sought. Encourage them to write to the insurance commissioner and government representatives. Parents can be especially effective in documenting the repercussions of the insurance problems and stressing the likely effects on their jobs and families.

8. Write an editorial for your newspaper. Appear on radio and television talk shows. Make presentations before your city council and civic organizations. Keep the problem visible in your community.

9. Collect data. NAEYC depends on you to keep us informed about the scope and nature of the problem. We can magnify our effect on the media, the insurance industry, and federal policy makers when we can provide data such as numbers of programs that have experienced nonrenewals, average sizes of rate increases, and numbers of programs that have ceased to operate. Ask for a sample survey form (see end of this article).

10. Plan ahead. Start several months before your insurance renewal date, so you will not be left without coverage.

What about NAEYC's insurance policy?

Throughout the last year, NAEYC worked with MarketDyne International (a division of CIGNA Corporation) to develop a child care center property and casualty insurance package that includes liability coverage. This NAEYC Safety Group Program offers property and center liability coverage, as well as optional automobile, workers' compensation, and student accident medical coverage. The maximum liability coverage is $500,000 per occurrence: Coverage for child abuse or sexual molestation is unavailable. We anticipate that rates will run $2 per 100 square feet for the liability portion of the policy. The annual premium for the full package will probably average $1,800, without the optional automobile, compensation, or student accident coverage.

Eligibility qualifications are quite stringent and include only programs that:

1. Have a capacity of 10 or more children, not provided in a private residence. This includes after-school care that meets all other criteria.
2. Operate at least 25 hours a week, or a minimum of 4 hours a day.
3. Enroll a majority of nonhandicapped children. A small proportion of handicapped children, as in mainstreamed classrooms, may be enrolled.
4. Maintain an emergency plan documenting staff-child ratios of 1:3 for children under 2; 1:5 for children ages 2 to 3; 1:10 for children ages 3 to 5; 1:12 for children ages 5 to 7; and 1:15 for older children. These ratios do not need to apply during routine care and education, but must include only regularly scheduled staff on the premises.
5. Have limited government financial participation or support.
6. Are licensed or exempt from licensing by state statute.
7. Employ staff trained in child development and/or early education, use careful hiring practices and a probationary period, and maintain constant adult supervision.

Ineligible operations include summer camps, family day care homes, overnight facilities, and centers specializing in work with handicapped or disabled children.

Each program that applies for coverage will complete a supplemental application—a preliminary screening form. You may request a copy of this application from MarketDyne. Once this form is processed, a local CIGNA inspector will probably conduct an on-site inspection of your program. This process can take from 6 to 8 weeks, so anticipate your deadlines as much as possible.

NAEYC's goal is to see that this plan is available to NAEYC members in every state. This is not now the case, although the situation is changing rapidly. We recognize that this policy will not solve the problem for everyone, and we are continuing to advocate for broader coverage for all types of child care programs.

For information about this plan, phone 800-523-2710 and ask for Robert LoConte. If you have *any* problems, and feel you meet the criteria outlined above, please call NAEYC Headquarters. We also want to keep track of states that are not writing this policy.

What else is happening?

In addition to the MarketDyne policy, negotiations are drawing to a close on another child care insurance policy that may be available in January. The Child Care Action Campaign (CCAC) worked over the summer with a coalition of child care representatives including NAEYC and a major brokerage firm in New York City.

The negotiators are extremely optimistic that an affordable child care policy will be made available. The policy would cover all licensed forms of child care—centers and family day care homes—and would not contain restrictions based on government funding or hours of operation. Moreover, an effort is being made to cover child abuse allegations.

Programs covered by this policy would be required to comply with basic safety guidelines, such as having smoke detectors and written evacuation plans, developed in conjunction with the child care coalition formed by CCAC. They would serve the dual purpose of protecting the integrity of the insurance program (thereby keeping rates as reasonable as possible), and assuring that clearly unsafe programs are not pooled with all other programs. Compliance would be subject to verification by a third party such as a child care licensing official, the administrator of a family day care association, or a designated volunteer group. Programs that are not in compliance would be given an opportunity to make necessary improvements prior to loss of coverage.

We will inform NAEYC members about this policy if and when it becomes available.

Where does this leave me?

We hope it leaves you poised for action. Call NAEYC with further questions, insights, creative strategies, and success stories. We will pass them on as we talk with other providers and child care advocates.

If you would like a copy of a sample insurance survey form for providers, send a self-addressed, stamped envelope to the Child Care Information Service at NAEYC Headquarters. And be sure to send us the results. We anticipate there will be more federal hearings and other opportunities to publicize this critical issue.

For information about NAEYC Safety Group Program call MarketDyne International, 800-523-2710 or 800-643-2020 (Pennsylvania residents only). For *specialized* questions, ask for Robert LoConte.

To obtain a copy of the sample insurance survey form, send a self-addressed, stamped envelope to:

Insurance Survey Form
Child Care Information Service
NAEYC
1834 Connecticut Ave., N.W.
Washington, DC 20009-5786

"The New Republic"
Dec. 9, 1985

The insurance crisis hits preschool.

GOOD-BYE DAY CARE

DAY CARE HAS become dangerous. Not for the kids. Contrary to what you might gather from the headlines, child abuse is very rare at day-care centers. The danger is to the people running the centers: they are being driven out of business because they are unable to get liability insurance. After a year of heavy losses throughout the insurance industry and of lurid stories about child molesting in preschools, companies are drastically raising their rates, excluding coverage for physical and sexual abuse, abruptly canceling or not renewing premiums, and getting out of the area altogether.

Triny McClintock, who runs the nonprofit Rockland After School Programs in Rockland County, New York, learned this summer that her liability premium was being increased by close to 1,000 percent, from nine dollars to $85 per child. At the same time, the insurance company began to specifically exclude coverage for sexual and physical abuse; she was told that to obtain it would cost as much as $10,000 a year. McClintock has never filed a claim of any kind. "The parents can probably afford the increase," she says, "but I can't afford to run the program without coverage for abuse. One suit could endanger my personal holdings." She has called numerous insurance agents in search of other policies, but with no success. Her own agent advised her to close the center. If by December she doesn't find the policy she's looking for, she will do just that.

The insurance industry's flight from day care is based more on vague alarm than on firm actuarial data. Although day-care policies have turned out to cost more to administer than insurers expected, there seems to be little evidence that they have proved particularly risky. James Strickland of Child Inc. in Austin did a computer search of articles in insurance journals from the past five years, which failed to turn up a single one citing child care either as "high risk" or "high loss." Strickland's own survey found that liability claims from child care and preschools were rare, and that when they did occur, the settlements weren't particularly large. Numerous insurance agents and brokers readily agree with him. What's more, although in the last year several insurance companies have settled claims for abuse, so far no jury has made an award for a case of physical or sexual abuse at a day-care center. The notorious McMartin Preschool case in Manhattan Beach, California, hasn't yet gone to trial.

The truth is that children are far more likely to be abused or neglected by someone in their own family than they are by their day-care teachers. The American Humane Association estimates that parents or other relatives account for 97 percent of the reported sexual abuse cases in this country; day-care employees account for barely one percent. And as Thomas L. Birch of the National Child Abuse Coalition testified this summer in congressional hearings on the child-care insurance crisis, far from fostering abuse, day care often helps to prevent it.

Nevertheless, the fears of the insurance industry aren't groundless. Insurers can't reasonably rely on past experience as a measure of potential future obligation. At a time when damage awards are rising in every area from neighborhood bars to entire municipalities, it's not surprising that insurance companies are wary about uncharted territory. Clever lawyers have stretched the definition of harm beyond recognition, and sympathetic juries are increasingly willing to assign responsibility for what once would have been construed as unfortunate accidents. Huge sums beyond all measure of actual loss are being routinely shelled out for "emotional distress" and for "punitive damages."

"If you're an insurer," says Peter Huber, a Washington lawyer, "there's no reason to suppose that the awards won't continue to go up. There is no built-in stopping point." Insurers, uncertain where the trial lawyers will strike next, are especially unnerved by all the publicity about child abuse. A few sensational cases such as McMartin's, with potentially large settlements for numerous plaintiffs, were enough to poison the prospects for every day-care center in the country.

When one is working with children, injuries of various kinds are not uncommon, and in day care the limits of liability have only begun to be tested. If a child throws a toy truck at his friend, causing a wound that will leave a scar, a mother might well sue the center for negligent supervision. Of course, if it had happened at home, under her watch, there would be no solace in the courts, and no one to punish except herself. Was the day-care center at fault? Hard to say, and expensive to determine. If the center is found negligent, another concerned mother, hearing about the suit on the local news, is more likely to consider filing charges when her daughter falls off her preschool's jungle gym. And no one has yet come up with satisfactory definitions for physical and sexual abuse. Rattled day-care employees now hesitate even to hug a child—for good reason. The St. Paul Fire and Marine Insurance Company, like many others, has devised what it calls a "no touch exclusion" for its day-care centers, which rules out coverage for physical and sexual abuse. Hence McClintock's inability to obtain the policy she needs, and her alarm.

BUT THE TORT system isn't the only force at work here. The insurance industry counts primarily on its investments—not its premiums—to keep itself afloat. In the early 1980s, when interest rates were high, companies entered an intensive price war and were temporarily able to maintain comfortable profits even after slashing the costs of their policies. When rates plummeted at the same time that liability awards rose, insurers suffered unexpected setbacks. Last year, according to industry figures, property and casualty insurers withstood losses of $1.5 billion. Panic set in, and insurers greatly expanded the list of businesses they deemed "high risk." Robert Hunter, president of the National Insurance Consumer Organization, points out, "When the South Bronx started to burn down, insurers pulled out of the North Bronx too. Day care is the North Bronx."

Some of that panic may have been feigned. Natwar Gandhi of the General Accounting Office notes that even though 1984 was the industry's worst year ever, it still had a net cash flow (thanks to a large cushion of reserves) of $11.7 billion *after* paying all claims and expenses. The insurance industry is not federally regulated, receives several special tax breaks, and enjoys immunity from the antitrust laws. Hunter and other consumer advocates charge that in fact the insurance companies are acting in concert to create a liability crisis in order to force a reckoning with the tort system.

WHATEVER THE CAUSE, the result is that insurance and litigation—social institutions intended to produce economic stability and social justice—are producing instability and chaos instead. In day care the ironies are particularly apparent. A crucial industry is discouraged from expanding, or even continuing, at a time of unprecedented demand. As a consequence, the risks that so worry insurers and parents—those that result from inadequate supervision of children—are made more likely. Thanks to exaggerated concerns about virtually nonexistent liabilities, many of the real liabilities of day care—high cost; insufficient supply; and widely inconsistent standards of care, licensing procedures, and regulation from state to state—are probably going to get worse.

Radical increases in insurance costs leave day-care directors with three unpleasant choices: they can scrimp on staff and curtail their services; they can continue without insurance; or they can pass on the increase to the parents. Lower salaries (most day-care workers already make subminimum wages) and fewer, less qualified staff mean more accidents, and more claims. Operating without insurance is not only foolhardy but illegal in many states. And paying for day care is already a struggle for many parents. The YMCA of Orange County, California, which runs 34 day-care centers, says that one of its two liability insurance policies recently rose from $2,700 a year to $83,000; their customers are being asked to assume the increase. A number of parents have already dropped out, and they expect to lose others. Without affordable day care, many parents face the prospect of either quitting their jobs or adding their kids to the growing ranks of "latchkey children." Needless to say, an unsupervised child at home is at much greater risk of being hurt or "neglected" than a child at the local Y.

The state of family day care is particularly precarious. Of the 20 million children in child care in this country, two-thirds of them are in family day care, the least expensive and most convenient option for most parents. A woman who watches three children during the day might not be able to afford an $800 insurance premium. Even if she can, it could be virtually impossible to obtain. In Baltimore County, 241 family homes had their insurance canceled this summer by a financially distressed company. Maryland's insurance commissioner, Edward Muhl, required the company to continue the policies until they expire at the beginning of the year. So far no replacement has been found. Most family day-care businesses (an estimated five million to six million) already operate illegally, unlicensed and unregulated. Expensive and scarce insurance will drive more homes "underground," and put others out of business.

What can be done to convince companies to insure day care? One sensible approach would please the insurance industry, but would be fought bitterly by the trial lawyers. Flat limits could be placed on liability, as has been done, for example, in nuclear power, worker's compensation, and—in some states—medical malpractice. And the statute of limitations could be shortened: a claim can currently be filed up until the child reaches adulthood. Peter Huber points out that "you can restore insurability to anything by making the damages predictable and finite."

Meanwhile, Governor Thomas Kean of New Jersey has issued an emergency regulation forbidding insurers in the state from sudden cancellations. Maryland and California are attempting a "Marketing Assistance Program," under which insurance companies agree to spread the risk by creating a group of insurers to which people in day care can apply for liability coverage. If the voluntary MAP doesn't work, there's always the "Joint Underwriting Association," under which insurers are *required* to cover certain risks if they wish to do business in the state at all. (It was the threat of a bill for a JUA in the California state legislature that prompted insurers to address the problem themselves.) And a group of day-care associations, headed by the Child Care Action Campaign in New York, is working out an agreement with one company to insure all day-care centers and family homes that meet its own accreditation standards. None of these efforts guarantees that insurance will be universally affordable, but they do at least make it available. In the long run, many believe, these patchy efforts will have to be replaced by old-fashioned, unpopular, federal regulations.

More than half of all mothers with children under age six have jobs, and the number is increasing. Whatever its problems, day care is indispensable—not only to parents, but to the industries, professions, schools, and government agencies that employ them. Lawyers and actuaries may be specialists in the business of managing unforeseen risk, but they have proved to be clumsy social engineers. It shouldn't be left to them to decide whether kids can go to day care.

DOROTHY WICKENDEN

[From the New Haven Register, Feb. 7, 1986]

Forum

Legal system not cause of insurance mess

By Bob Hunter
and
Jay Angoff

Last year, just as they had done in 1976, insurance companies dramatically raised the cost of liability insurance for businesses, doctors, local governments and others. Or they simply refused to provide coverage at any price.

And, as was the case almost a decade earlier, the industry claimed that huge jury awards and a litigation "explosion" had left it with no choice but to raise rates and cancel policies.

Yet judges and juries did not get stingy in the intervening years. Nor did the number of lawsuits decline.

Rather, insurance premiums rose dramatically in 1976 and 1985 due to the cyclical nature of the insurance industry. Insurers cut their prices when interest rates, and thus their income from investing the premiums that they collect, are high. They raise rates when interest rates, and thus investment income, are low. They overreact at the top and bottom of the cycle.

In 1981, for example, with both interest rates and the rate of return on equity running near 20 percent, insurers were "begging for business, at any price, to get premium dollars to invest," according to the president of a large New York insurance brokerage. Insurers even wrote policies for those harmed in the Las Vegas MGM Grand Hotel fire — after the disaster occurred. They believed they would earn more by investing their premiums immediately than they would lose by paying out claims in the future.

Today, on the other hand, interest rates have declined. The industry finds itself paying claims on policies that were written back in the days of hyperinflation, when its rates were too low. So, just as it did in 1976, the industry substantially raised rates — by an average of 72 percent for general liability policies — and reduced coverage. Meanwhile, the index of property-casualty-insurance stocks rose by 50 percent — almost twice as much as the Dow Jones industrial average.

To flatten out the insurance cycle, and thus bring down insurance rates and prevent sharp increases in the future, Congress should do the following:

— Subject the insurance industry to antitrust laws, thus preventing insurers from acting in concert to raise prices. Since 1945 the McCarran-Ferguson Act has allowed insurance companies to fix prices, while price-fixing in other industries is punishable by up to three years in jail.

— Create a federal office of insurance to monitor the industry and establish standards for state regulators to follow. Although insurance is a national, $310 billion business, accounting for 12 percent of our gross national product, only the states regulate the insurance industry. Because state insurance commissions are often understaffed (half the states have no actuaries to analyze rate filings) and have a "revolving door" relationship with the industry (state insurance commissioners typically come from and return to the industry), state regulation has not always protected the public.

— Repeal the insurance industry's exemption from Federal Trade Commission jurisdiction. In 1979, after the FTC published a study critical of the life-insurance industry, Congress prohibited the agency from ever again studying — let alone prosecuting — any sector of the insurance industry. There is no principled justification for this exemption.

— Expand the Risk Retention Act, which allows manufacturers — but not other businesses such as day-care centers and nurse-midwives — to join to buy insurance at a lower rate. This would preempt state laws prohibiting such group buying. Automobile owners, for example, who must now buy insurance individually, could reduce their premiums by 10 percent a year by buying in groups.

— Establish a national re-insurance program to be funded by the insurance industry. Re-insurance is insurance for insurance companies: The insurer pays the re-insurer a premium, and the re-insurer agrees to share the risk with the insurer. The re-insurance market is dominated by Lloyds of London. Because neither the federal nor state governments effectively regulate Lloyds, American insurers have no recourse when the British firm raises its rates, as it did last year. An American re-insurance program would compete with Lloyds and exert downward pressure on re-insurance rates, which in turn would enable insurers to reduce their rates.

It is the insurance industry, not the legal system, that is most in need of reform. Placing limitations on jury awards will not bring rates down. Ending insurance rate cycles will.

Bob Hunter is president of the National Insurance Consumer Organization in Alexandria, Va. Jay Angoff is the organization's counsel.

The Chairman. Thank you very much, Judy.

We're going to keep on going with all the witnesses, and then if we have questions, we will ask them at the end.

STATEMENT OF KAREN EHRNMAN, COORDINATOR OF GOVERNMENT RELATIONS, AMERICAN COLLEGE OF NURSE-MIDWIVES, WASHINGTON, DC

Ms. **Ehrnman**. Good morning. My name is Karen Ehrnman, and I represent the American College of Nurse-Midwives. I have been invited to share with you the difficulties which certified nurse-midwives have had in obtaining professional liability insurance coverage. In fact, since last July, certified nurse-midwives have been without a blanket professional liability insurance policy.

The impact on America's small businesses in relationship to certified nurse-midwives is twofold. Approximately one-third of our members are in private practice; in addition, another segment of our membership either owns or provides most of the health care in our Nation's 140 accredited birth centers. The birth centers have also lost their professional liability insurance.

Our written testimony goes through all of the steps which we have taken during this past year to obtain professional liability insurance. We have been unsuccessful. As a result, what we are focusing on currently is trying to establish our own independent mutual insurance company, and most of my comments this morning are going to be in terms of the roadblocks, the problems that we're having in establishing this company.

But first, just so we're on the same wavelength, a few words about certified nurse-midwives. They are nurses who have advanced education in midwifery at one of 26 educational programs across the United States. We have approximately 2,500 certified nurse-midwives across the country. They deal primarily with normal, healthy women, and they always work in clinical collaboration with physicians. They are legal in all 50 States and have an outstanding record of providing high quality health care.

Most important for purposes of this discussion today, they cannot work without professional liability insurance.

Our testimony goes through the whole story of how we lost our insurance, that the loss of insurance had nothing to do with the rate of claims against certified nurse-midwives; in fact, only 6 percent have ever been sued. It describes the temporary types of insurance coverage under which nurse-midwives are working. The testimony also describes the field of obstetrics and how it's not just nurse-midwives but the whole field of obstetrics which is encountering this problem. And it explains all the steps which we've taken—to interest traditional insurers in insuring us and working with States. This has not been an effective strategy—to be included under joint underwriting authority in States. I'll cite New York State. The premium there is $72,000 and the average salary of a certified nurse-midwives is $25,000.

In addition, earlier this fall we had come to Congress and we had asked them if perhaps we could find a primary insurer, if Congress would consider being a reinsurer.

Because of the difficulty with all of these options, at the present time our board—had decided to try to form our own insurance company. And let me just share with you a few of the problems that we're having.

All temporary insurance coverage runs out this spring. Therefore, we need to have our new company up and running from June or July. In order to do that, we need to come up with capitalization requirements of between $3 million and $4 million. However, that obstacle is small in comparison to the regulatory roadblocks.

We have been advised by our attorney that, in order to form this company and have it operate in all 50 States, it must be licensed in each of the 50 States. This requires tremendous time—we've been advised several years, oftentimes—as well as financial resources.

Without the insurance company in all 50 States, it doesn't meet our needs. Therefore this regulatory roadblock is overwhelming at the present time.

In addition, I would like just to mention one technical problem, and there are many in this insurance business. This problem has to do with the switch now, which some of the previous witnesses have alluded to, from occurrence-type policies to claims made. And I'll refer you to our written testimony on specifics of what these policies cover. However, for nurse-midwives and obstetricians and other health care providers, switching to a claims-made policy is very, very difficult. It means that if I were insured, for example, this year—this February 1986 through February 1987—and were to deliver a baby, and the claim for a child having a health problem was not registered for 10 years, under a claims-made policy I would not be covered. My insurance company would not pay for that claim. It would only pay if the parents had, in fact, submitted the claim during this calendar year.

The way insurers suggest that groups such as ours get around this is, you purchase what you call a "tail." However, right now, because of the insurance climate, you can't even purchase a tail; and if you can, sometimes it's for a very short amount of time.

So this means that for nurse-midwives, we're looking at trying to get around the regulatory roadblocks; getting around the financial roadblocks; having to settle for a claims-made policy with a limited tail, which means that down the road nurse-midwives could have claims which occur when they don't have a tail, and under which their own personal assets will be attached. And this is making the entire profession very nervous.

Today, we're coming here and talking with you and asking for help in three areas.

First, amending the 1981 Risk Retention Act. This would allow us to legally operate in all 50 States; and, as I explained, that would be a great, great help.

Second, we have a problem with reinsurance. That's also been alluded to; reinsurance is unavailable. As we open up our own company or as we try to plan to open it up, it will be without reinsurance and this greatly increases our financial risks.

Third, take whatever steps are necessary to bring back occurrence policies.

Thank you.

[The prepared statement of Ms. Ehrnman follows:]

STATEMENT OF KAREN EHRNMAN ON PROFESSIONAL LIABILITY INSURANCE FOR CERTIFIED NURSE-MIDWIVES: COST AND AVAILABILITY, BEFORE THE SENATE SMALL BUSINESS COMMITTEE

FEBRUARY 20, 1986

Good morning. My name is Karen Ehrnman and I represent the American College of Nurse-Midwives (ACNM). I have been invited to share with you the difficulties which certified nurse-midwives have had in obtaining professional liability insurance coverage.

This testimony will chronicle the extensive yet unsuccessful steps the College has taken on behalf of its members to obtain professional liability insurance. Additionally, I shall describe the obstacles resulting from the decision made by the College to study our options to assist nurse-midwives in establishing an independent mutual insurance company.

The impact of this situation on America's small business community is twofold: approximately one-third of our members are in private practice; another segment of our membership either owns or provides most of the health care in accredited birth centers. Until now, the nation's 140 birth centers have been a success story in the small business world. During the first three years of business only eight to ten percent of these businesses have failed. However, these centers have also been unable to obtain professional liablity insurance and as a result twelve have closed in 1985.

As a result of the unavailability of insurance from the private sector, the establishment of an new insurance company is the only option available to nurse-midwives to obtain professional liability coverage. Without this company, nurse-midwives will be forced to end their services to mothers and children across the United States. Birth centers will close and private practitioners will seek other livelihoods.

Background on ACNM

The American College of Nurse-Midwives (ACNM) is the professional organization for nationally certified nurse-midwives (CNMs) in the United States. There are approximately 2,500 members of the ACNM, representing close to 85% of the profession. A full 95% of the members carry some type of professional liability insurance coverage.

Certified nurse-midwives are highly trained health professionals. Educated in both nursing and midwifery, they are specialists in maternal and child health care. They are licensed in all fifty states and provide care to the healthy woman before, during and after childbirth. They are experts in normal gynecologic and family planning care. Each member of the College has been officially certified through a national written examination.

The nurse-midwives work in a variety of settings -- such as private practices, university teaching hospitals, city hospitals, rural outreach centers, group health maintenance organizations, and health departments. Nurse-midwives deliver about three percent of the births in the United States. Approximately 75% of the births attended by certified nurse-midwives occur in hospitals, and another 15% occur in accredited birth centers.

Certified nurse-midwives work in clinical collaboration with physicians. ACNM standards require members to have an alliance agreement and health care protocols with a physician in order to practice. These agreements and protocols establish mechanisms for consultation and referral when complications arise.

ACNM also has reached a formal agreement outlining acceptable guidelines for working relationships with the American College of Obstetricians and Gynecologists.

Details of the Current Insurance Crisis

Since July, 1984, about 1400 CNMs have had professional liability insurance under a blanket ACNM policy written by the Mutual Fire, Marine and Inland Insurance Company. The remaining 1100 members of the College are insured by their employers -- hospitals, health maintenance organizations, etc.

Mutual Fire notified ACNM in May, 1985 that the policy would not be renewed on July 1, 1985. ACNM's insurance was not renewed because of general conditions in the insurance industry -- the unavailability of reinsurance -- and not because of its members' professional performance. Suits have been filed against only six percent of all nurse-midwives -- a number not considered high among medical professionals. By comparison, 66.9 percent of obstetricians have been sued at least once according to the American College of Obstetricians and Gynecologists. In addition to the non-renewal of the blanket policy, this past July over 300 individual certificates of insurance were cancelled. These cancellations accounted for all of the individual certificates of insurance written after December 31, 1984. The remaining 1100 policies expired by December, 1985.

History of Insurance Coverage

Since the early 1970's the American College of Nurse-Midwives has been able to obtain for its members a group policy that would pay up to one million dollars per claim. This one million dollar amount of insurance is the amount which many hospitals require nurse-midwives to purchase in order to qualify for hospital privileges. It is this amount of insurance we want to make available to our members today.

Mutual Fire Marine and Inland Insurance was the third insurance carrier the ACNM has worked with in the past three years. The change in companies has been the result of three separate situations: 1) the inadequacy of the premium rate charged by one company; 2) the second company's withdrawal from the medical malpractice market; and 3) the nonrenewal of the reinsurance treaties for our most recent policy.

Steps Taken to Obtain New Insurance Policy

Early this year when ACNM received word that obtaining the master insurance policy might be difficult, we selected a "seasoned" broker with an excellent history of obtaining professional medical liability insurance. We believed that our broker understood what nurse-midwives are and that he would "market" us appropriately to the insurance industry. In search of a replacement for Mutual Fire we contacted 17 insurance companies in the United States. We were told that this represented most carriers in the U.S. who write professional liability insurance. We were turned down by all of these companies.

Judging from the response we received from these insurance companies, we learned that many insurance companies had simply stopped writing malpractice policies. We also learned that within the speciality area of obstetrics, a crisis within a crisis was occuring. Insurers claim that the large premium increases which obstetricians and others are experiencing are necessary because of loss of income resulting from unexpected large numbers of claims and skyrocketing awards. What was never actually said -- but implied -- was that the premium levels necessary to cover CNMs would be beyond the reach of professionals making an annual salary of $25,000. Therefore, they offered no coverage at all.

But consumer groups, such as the National Insurance Consumer Organization (NICO), have accused the insurance industry of using misleading statistics in claiming a loss in 1985. Instead NICO suggests the insurers have earned $6.6 billion. The ACNM is not an insurance analyst. We do know that nurse-midwives are part of the solution to the medical malpractice problem because of our very low rate of suits. We believe that it would have been possible for an insurance company to write a policy for nurse-midwives at a reasonable rate and based upon sound actuarial data. In fact, as I shall discuss later in this testimony, our plan is to do just that -- to establish an independent mutual insurance company which will underwrite CNMs at a resonable rate.

After these 17 formal rejections from major insurance companies, ACNM made personal appeals to several insurance company presidents. We did this for several reasons: to better inform them about the relatively low risk that certified nurse-midwives would place upon their companies; to understand their reason for not insuring nurse-midwives; and to be certain that our request for insurance had been given a full evaluation. The response was still "no".

The American College of Nurse-Midwives again wrote to each of these 17 company presidents asking them to reexamine the decision. Many of these letters went unanswered. The message was clear -- no insurance.

State Level Initiatives

Our next course of action was to send nurse-midwives to talk with professional liability insurance companies in their states. The response was still "no". Nurse-midwives talked to governors, state legislators, and state insurance commissioners. To date only one state out of fifty -- New Jersey -- has been able to offer insurance from a private carrier.

Still focusing at the state level, nurse-midwives investigated joint underwriting authority (JUA) and lobbied state legislators to extend joint underwriting authority to include nurse-midwives. We have been successful in implementing this in a number of states. However, for the most part, either the premiums for this coverage have been excessive or the amount of insurance offered has been less than required.

Other Considerations

As we evaluated the situation, nurse-midwives had little hope of obtaining affordable insurance from either the traditional insurers or the state JUAs. While these two options had been under consideration, the College's Board of Directors also commissioned a feasibility study on various options for self-insuring. Although this study indicated that it would be "feasible" for nurse-midwives to form an insurance company, the Board of Directors decided last summer that the insurance business was beyond the limited resources of nurse-midwives. The Board directed the staff of ACNM to look into working with other groups to self-insure or to join another group's self-insure program. The response to these inquiries was also "no", although ACNM continues to communicate with the American Nurses' Association (ANA) about forming a company for all nurses.

Another option involved asking Congress to consider establishing a nurse-midwife sponsored insurance program. At that time we had interested a primary insurer in writing the first layer of insurance coverage. That company would have written the first $100,000 of coverage and the federal government would have provided the excess coverage from $100,000 to one million dollars. Even as we discussed this with members of Congress, however, the primary insurer had a change of heart.

The Re-examination of Self-Insure

Consideration of all of the options discussed up to this point utilized an enormous amount of resources. The process also strengthened the resolve of the leaders of the profession that searching for insurance could not become an annual event. Therefore the College's Board of

Directors sought a second opinion on the self-insure options. This second evaluation confirmed the earlier one. In December, 1985, the Board of Directors decided to further study this option.

Forming an Insurance Company

The emotion which accompanied the decision to study helping certified nurse-midwives form an independent mutual insurance company was short-lived. Even after hiring consultants and attorneys, the road blocks before us are enormous.

Disregarding the financial problems, the following are some of the legal and technical complications which hinder the establishment of a company.

The Claims-Made Policy

One technical problem is the type of policy currently being written -- a claims-made policy. In the past professionals have been able to purchase occurrence policies. There is a very important distinction between these two types of policies -- a distinction which is critical to nurse-midwives as well as physicians.

An occurrence policy insures for all claims arising out of events which occurred during the covered period regardless of when the claim is filed. A claims-made policy insures only those claims which are filed during the policy year no matter when the event occurred. Does it matter? Yes.

For example, under an occurrence policy issued in February 1986 - February 1987, the nurse-midwife would be covered for any claim related to a delivery during this calendar year, even if the family did not file the claim until the child entered elementary school or even college. A claims-made policy, on the other hand, would only cover those claims filed during the February 86 - February 87 calendar year. To be covered for claims filed after this time period the professional must purchase "tail coverage". What further complicates all of this is that in this insurance market it is impossible to buy a "tail" for 21 years -- the coverage that nurse-midwives and obstetricians need. In addition, insurance companies will not quote a price on a "tail" until it is needed, but we have been told it is likely to be two to three times the cost of a one year premium -- and can be more. We have been told by the insurance industry that primary insurers are switching to claims-made policies because reinsurers will not write occurrence policies. Reinsurers argue that it is easier to anticipate costs with a claims-made policy.

Regulatory Roadblocks in Forming an Insurance Company

Simply stated, we have been informed by our legal counsel that under the insurance laws of virtually all of the states, a new insurance company could not write insurance unless it became licensed in each of these states. This is a costly and time-consuming process that takes several years -- time we simply do not have. Also, the capital requirements of a few of the states exceed even our collective resources. Our legal counsel has reviewed the situation to see if exemptions from this licensing process exist, but none is available to us due to the number, size and geographic spread of our membership.

In 1981, Congress realized that this almost identical problem existed for small businessmen affected by the lack of product liability insurance, when it enacted the Risk Retention Act. This Act allowed groups of business to form risk retention groups to collectively insure the product liability risks of the members of the group without first becoming licensed as an insurer in any jurisdiction other than that of the domicile of the risk retention group itself. In 1985, Congress again realized that a similar problem existed when the House and the Senate passed an almost identical bill (which is part of the Super Fund legislation now before Congress) to provide for risk retention groups for environmental impairment liability insurance.

We would ask you to provide us with the same type of legislation to permit formation of a risk retention group for professional liability insurance for nurse-midwives and birthing centers.

Nurse-midwives Current Status: Temporary Insurance Coverage

In considering practicing without insurance, most CNMs, as well as most physicians, feel both a moral and practical obligation to protect their patients and themselves from any unintentional human error. In addition, many CNMs must carry professional liability insurance to retain their employment and/or hospital privileges.

In an attempt to keep practicing, most of our members purchased insurance during this past year from one of two nursing groups whose policies did not include an exclusion of nurse-midwives. These organizations are the American Nurses' Association (ANA) and the Nurses' Association of the American College of Obstetricians and Gynecologists (NAACOG). The insurers of both of the groups have subsequently written into the policies exclusions of nurse-midwives. An informal survey of our membership indicates that this temporary coverage will begin to run out this spring and by next December no CNMs will have insurance if not provided by their employers or state JUA.

Requested Actions

Therefore, I am certain you will agree with us that the formation of the insurance company over the next few months is critical. Congress can help us. We urge Congress to: amend the 1981 Risk Retention Act; address the problem of the unavailability of reinsurance; and establish the availability of occurrence-type policies.

1) Amend the 1981 Risk Retention Act.

An expansion of this law to allow groups such as ours to establish an insurance company is essential. The idea we seek to implement is after meeting the requirements in a selected state for establishing the company, the company would be able to write insurance in all fifty states. This is the only way that we will be able to offer insurance to our members in all fifty states.

2) Address the problem of the unavailability of reinsurance.

Our problem began when Mutual Fire's reinsurance treaties were not renewed. Since then we have heard many insurers state that their capacity to write insurance is limited by the unavailability of reinsurance. A new company also cannot get reinsurance and this substantially increases both short and long term financial risks.

In this regard, the American College of Nurse-Midwives urges you to make reinsurance available. This could be done by legislating the plan for federally-based reinsurance which has been drafted by the National Insurance Consumers Organization and investigating U.S. business practices and legislating changes to encourage the establishment of U.S. owned reinsurance companies.

3) Make occurrence policies available.

Nurse-midwives cannot purchase an occurrence policy. In addition, in studying the possible formation of a new company, we have been advised that this company would also have to write a claims-made policy. The reason is that reinsurers will only reinsure the claim-made type policy. This situation must be changed.

Lastly we need this assistance quickly. Although some private practices and birthing centers have already gone out of business, the vast majority of these small businesses will be vulnerable this spring. Thank you for your support and interest in this problem.

The CHAIRMAN. Thank you very much.
Mr. Lipshie.

STATEMENT OF NORMAN W. LIPSHIE, MANAGING PARTNER, WEBER, LIPSHIE & CO., NEW YORK, NY; REPRESENTING THE NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

Mr. LIPSHIE. Thank you, sir. My name is Norman Lipshie; I am the managing partner of a medium-sized accounting firm in New York City. I am the immediate past chairman of the professional liability committee of the New York State Society of Certified Public Accountants, and I'm here representing them.

At the time that we lost our sponsored carrier last June, we had 1,560 practice units insured under the program; 600 of those units have been insured by American Home; 300 still have time to go on their present policy; 200 have found coverage someplace else. But over 460 have gone bare in addition to those that were bare before. This is a frightening statistic because I don't know how anybody can sleep and practice accounting in this litigious atmosphere that we have today.

The public has now been affected with the increased cost of insurance. Although the increase in rate may not actually pass through to the client immediately—though it will soon—I can attest to the fact that accounting firms are practicing more defensively, sometimes to excess, out of concern for the consequences of even unjustified lawsuits. The client is paying for this directly now.

Whereas in the past, the profession was eager to help new business and venture firms, it is now more reluctant to do so because the personal risk is just not worth what may be an exposure. Even the larger firms are shying away from SEC work and, in particular, initial public offerings.

More important, many businesses occasionally get into financial straits. This is when you need your accountant the most; yet, many accountants are leaving these clients because of the obvious risks involved. This is unfair to small business, but dictated by the professional liability crunch.

At present, there are three companies writing in New York State. One is a group policy for public accountants which has recently admitted certified public accountants with five or less CPA's on their staff. They have had a good history because public accountants don't attest. I wonder what's going to happen when the CPA's—recently admitted—start doing projections and certifications to this plan?

Another insurance company is that sponsored by the American Institute, who has had continual problems with its reinsurance. They do not provide a tail. If they lose their reinsurance, I don't know what's going to happen to all the people they have been insuring because American Home will not take new companies without a tail. American Home at the moment is writing certain risks to a maximum of $5 million liability.

I'm not going to go into my own personal war story— it's brutal and gory—except to say that when we renewed our policy October

31, our costs on an apple-for-apple basis were 10 times our prior year's cost. And since then, rates have gone up another 30 percent.

You might ask why other insurance companies have not entered what appears to be a lucrative market. Apparently, the problem is with the reinsurance treaties. Every time there is mention of a company coming in, we are told that they are unable to get reinsurance even in such markets as Hong Kong or London. This is probably partly due to the atrociously high awards that have been awarded to claimants and because of the propensity for juries to compensate—sometimes erroneously, and frequently excessively—those that they feel have been wronged. It's easy to criticize the accountant in front of a jury. The accountant's defense is often correct; but because it is technical, it fails to convince a lay person.

I would like to talk about our clients. All liability insurance cost has risen at a tremendous rate. In some instances, costs have been passed on; but in most instances these costs have been absorbed, assuming that the insurance was available. Some of our more respected and substantial clients have chosen to be self-insured for risks such as product liability insurance because the costs are so prohibitive. Directors insurance is almost unobtainable. More and more outside directors are now becoming consultants because they don't want the risk of being an outside director. Clients in the trucking business, for instance, find insurance impossible and are actually going out of business.

It is interesting to note that if a business is compelled to raise its prices, it may no longer be competitive with foreign sources, which must eventually hurt this country because foreign suppliers do not pay the kind of insurance that American people do.

In the present market, it is almost impossible for a new business to start up and be properly insured. The very essence of the American dream—unlimited opportunity—no longer exists.

Several groups in various professions, as we just heard, are seriously considering captive insurance companies. These are born of necessity, and they might work, with the help of Government. Our experts tell us that in order for a captive insurance company to be successful in the accounting profession, there will have to be a shared deductible. A shared deductible, to me, presents a tremendous conflict of interest. If I am working for creditor's committee and part of my job is to examine a previously prepared financial statement by a firm that is in my captive, I have to resign because I have a conflict of interest, as I might have to not accept certain assignments in litigation and litigation support. This means that the public is being denied a lot of expert services. It shouldn't happen.

Certainly, at the State level, some legislation is in order. A more rational statute of limitations; nonjury trials; elimination of punitive damages; as we've heard before, proportionate liability as opposed to the present joint and several liability; and limitations on or eliminating contingent legal fees.

At the Federal level, I think the problem of RICO has to be addressed because I think this is the greatest deterrent for a new insurance carrier to come into the market. And I might suggest that the Federal Government will sooner or later have to subsidize the insurance industry to the extent of providing reinsurance, as they do with GNMA or some of the other obligations of the Government.

In my opinion, the small businessman and the professional man are devastated by the high costs of liability insurance, if they can get it.

I thank you for this opportunity to express my views.

[The prepared statement of Mr. Lipshie follows:]

REMARKS OF NORMAN W. LIPSHIE
BEFORE THE SENATE SMALL BUSINESS COMMITTEE
FEBRUARY 20, 1986

I am Norman W. Lipshie, a Managing Partner of Weber, Lipshie & Co., a Certified Public Accounting Firm, with offices in New York and Los Angeles. I am a Director of the New York State Society of Certified Public Accountants, and a Trustee of the Foundation for Accounting Education. I am a member of the Sub Committee of the State Board of Accountancy, which has been established to oversee the study on Mandatory Continuing Education. For the past five years, I have been a member of the Professional Liability Insurance Committee of the State Society, and its Chairman for the past two years.

Weber, Lipshie & Co. has 18 partners, 13 of whom are in New York. Professional staff varies depending on the time of year, from 120 to 150 people of which approximately 1/3 are in California. We service a diversified clientele categorized as the "middle market". The "middle market" has been defined as firms with sales volume of $1,000,000 to $200,000,000. Our largest client has a volume of approximately $150,000,000. In New York, approximately 15% of our volume is in the Debtor-Creditor relations field, and 5% is in special work. The balance of our income is from tax work, audit work and management services. In California, substantially all our income comes from tax work, audit work and management services. Our largest single client accounts for approximately 2% of our volume. We serve a few publicly owned clients, and are members of the SEC Section and the private practice section of the American Institute of Certified Public Accountants Division For Firms, and have been peer reviewed twice, and received an unqualified reviewers opinion.

When I became Chairman of the Professional Liability Committee at the State Society, we negotiated a renewal of the Sponsorship Agreement with the carrier at the time (INAPRO). Within a period of six months thereafter, we received indications that the sponsored carrier was very unhappy, and was putting certain restrictions on the policies they were willing to write, which no longer made sponsorship acceptable. We then negotiated a "friendly" termination of the Sponsorship Agreement. At that time, the program insured approximately 1,560 practice units out a total of approximately 2,800 practice units in the State. To the best of my recollection, INAPRO ceased writing in New York State on June 1, 1985. Since that time, the administrator of the Plan for the State Society has done a survey which indicates that an excess of 26% of practice units formerly insured under the Plan, have been forced to go without insurance.

The public has now been affected with the increased cost of insurance. Although the increase in rate may not actually pass through to the client immediately, I can attest to the fact that accounting firms are practicing more defensively, sometimes to excess out of concern for the consequences of even unjustified lawsuits. The client is paying for this directly.

Whereas in the past, the profession was eager to help new business and venture firms, it is now more reluctant to do so, because the personal risk is just not worth what may be an exposure Even the larger firms are shying away from SEC work and in particular, initial public offerings.

More important, many businesses occasionally get into financial straits. That is when they need their accountants most. Yet, many accountants are leaving these clients because of the obvious risks involved. This is unfair to small business, but dictated by the professional liability insurance crunch.

At present, there are three insurance companies writing in New York, two of which will only provide $1,000,000 insurance. One of those two will only insure firms who have principals and staff of 5 CPA's or less. The third firm will insure newly accepted applicants to a maximum of $5,000,000.

My last year of service as Chairman of the Committee, occurred at the beginning of this debacle. I was receiving between 8 and 10 calls a week from practitioners, either asking advice or complaining about the state of the market and the premiums that they were being asked to pay. Little did they know, that at that time prices were relatively inexpensive.

For the year beginning October 31, 1984, our firm purchased $15,000,000 of liability insurance with a $25,000 deductible per claim, and paid a total premium of $48,812. For the year beginning October 31, 1985, we purchased $10,000,000 liability insurance, (all that was available) with a $500,000 deductible for $197,785. In addition, as a condition precedent to obtaining this insurance policy, we agreed to purchase a six year discovery option from the prior insurance company for $73,128, so that our cash outlay for less insurance went from $49,000 to $271,000 in one year. Had we taken a $50,000 deductible, $10,000,000 insurance would have cost $312,682. In other words, $450,000 of insurance would have cost us $115,000. Our business decision was to accept this risk and we were forced to insure only for the catastrophe. Since October 31, 1985, our insurer has increased its premiums an additional 30%.

The smaller practitioners found themselves faced with premiums of 8 to 10 times their last year's costs. As I have indicated, many went bare. We are seeing more and more mergers of smaller firms into larger firms, and insurance costs and lack of ability to obtain insurance are a strong stimulus to this phenomenon. We ourselves are receiving inquiries from smaller firms, because they are unable to properly insure themselves.

Soon the public will no longer have the choice of professional that they once had.

You might ask why other insurance companies have not entered what appears to be a lucrative market. Apparently, the problem is with the reinsurance treaties. Every time there is a mention of a company coming in we are told that they are unable to get reinsurance even in such markets as Hong Kong or London. This is probably partly due to the atrociously high awards that have been awarded to claimants and because of the propensity for jurors to compensate sometime erroneously and frequently excessively those that they feel have been wronged. It is easy to criticize the accountant in front of a jury. The accountants defense is often correct, but because it is technical, it fails to convince a lay person.

I would like to talk about our clients. All liability insurance cost has risen at a tremendous rate. In some instances, costs have been passed on, but in most instances these costs have been absorbed, assuming that the insurance was available. Some of our more substantial clients have chosen to be self-insured for risks such as product liability insurance, because the costs are so prohibitive. Directors insurance is almost unobtainable. More and more outside directors have become consultants, which is a deplorable condition. Clients in the trucking business, for instance, have been unable to obtain any insurance and have actually had to go out of business. The small business man today is faced with a terrible decision; either he takes the risk of being uninsured, or he goes out of business. It is interesting to note that if a business is compelled to raise its prices, it may no longer be competitive with foreign sources, which eventually must effect this country to its detriment.

These are not isolated instances. They are typical. If we continue to let premiums escalate, it is only a matter of time before business after business will disappear.

In the present market it is almost impossible for a new business to start and to be properly insured. Insurance companies are looking at past histories, and then charging unacceptable premiums. New business finds that insurance is unavailable. It is becoming more and more difficult for a new business to obtain satisfactory professional advice. The very essence of the American Dream, unlimited opportunity,no longer exists.

In my opinon, the present situation was caused by the insurance companies themselves who, in the late 70's and early 80's, came into a market they did not understand, and they underpriced. This was fine as long as interest rates were spectacularly high, because the income that the insurance companies were enjoying from investments at high interest rates compensated them for the low premiums. As interest rates dropped, and the plaintiffs bar became more and more active, the insurance companies found themselves in an untenable position. For instance, the New York State Sponsored Plan had collected approximately $18,000,000 in premiums. When the sponsored carrier left the market, they had reserves and payouts of approximately three times the premiums that they had collected. We cannot ignore the fact that we live in an extremely litigious society. People who are hurt no longer say how can I get well - now, it's how much can I collect.

Sooner or later the public will pay an increased cost for goods and services. Over the short term, many businesses may be driven out by damage awards exceeding their ability to pay.

Several groups in various professions and industries are seriously considering captive insurance companies. These are born of necessity which might work with the help of government. Certainly, at the State level, some legislation is in order; such as a more rational statute of limitations, non jury trials, elimination of punitive damages, proportionate liability as opposed to the present joint and several liability, and limitations on or eliminating contingent legal fees.

At the Federal level, the problems of RICO as it relates to small business and the professions must be addressed, because the actual threat of this kind of law suit is one of the most detrimental problems that insurance carriers can face. There might have to be an exemption from anti-trust legislation, but I think that eventually the Federal Government is going to have to consider some sort of subsidization, such as CNMA to provide reinsurance to the liability market.

In my opinion, the small business man and the professional man is devestated by the high costs of liability insurance, if he can get it. Those who are operating without insurance, will be unable to pay the claims in the present environment, and will either flood our bankruptcy courts further or will voluntarily retire from the market place as their exposure becomes more evident. Liability exposure is probably the most serious problem facing the professions and the small business man today.

I thank you for this opportunity to express my views before you.

The CHAIRMAN. Thank you, Mr. Lipshie.
Mr. Brine.

STATEMENT OF WILLIAM H. BRINE, PRESIDENT, W.H. BRINE CO., MILFORD, MA; REPRESENTING THE SPORTING GOODS MANUFACTURERS ASSOCIATION

Mr. BRINE. Thank you, Senator, for allowing us to come here today and to testify on the product liability problems that we in the sporting goods industry have; and more in particular, in my own company.

My company is one that's owned by my brother and myself. It was founded by my grandfather in 1922. We have approximately 3,500 dealers throughout the United States and the world, and most of those are small businesses. As a matter of fact, the sporting goods industry as an industry, is a small business industry. When a large corporate conglomerate comes into the industry, it usually fails because our industry requires some very specialized knowledge and skills which are found only in the small business sector of the market.

Our company is small; we do about 7 million dollars' worth of business a year. We have 75 employees, of whom 85 percent are women and 22 percent are minorities. We have a number of pretty good athletes on our staff. We pride ourselves on the fact that we have a dominant position in the lacrosse market and in the better soccer ball market in the United States, as well as in the world.

It doesn't do much good to pride yourself in that, if you have some problems. And we have one huge problem, which is the same problem that the whole industry has, and that is product liability. Before I came here, I did an informal poll of most of the fellows that I could get in contact with in our industry. Without any question of a doubt, it was the No. 1 problem.

To illustrate my own problem, 2 years ago I paid $8,000 for 25 million dollars' worth of liability. Last year, at the last minute, 4:45 on a Friday, I was told I had to make my decision whether I wanted the insurance or not; and my cost would be $80,000. I had to do it by 5 o'clock, so I had 15 minutes to make my decision. We obviously made our decision and paid the $80,000.

This year came along, and they now want to charge me $200,000 for 1 million dollars' worth of coverage, which is on a claims-made basis and not on the basis of an occurrence. Well, that's fine; it got to the point where it was absurd. But the worst part of it is that if I wanted to go and buy a tail, the tail would cover me for 2 years. If you had a boy who was injured when he was 14 years old, he didn't reach his majority until he was 21. And at 21, he then had another 3 years for the statute of limitations. That's 10 years, so that no tail that I could buy would cover me. So that was my problem there.

Who is to blame for the problem? Well, it doesn't do much good to point fingers at anybody. Everybody seems to be partly to blame, but I'll illustrate a couple of cases that I've got in my testimony here, and I'd just like to bring them forward again.

One is a case where we are being sued for $100,000 for the impairment of the eyesight of a girl who played soccer at a pickup game at a State college. She kicked the ball. It bounced on the knee of an opponent. And then it came back and hit her on the temple and in some way impaired her eyesight. There was no supervision. The ball was never found. Three weeks later the coach went with the lawyer to the school. The lawyer picked up a bag of balls that happened to be in the school. Three of the balls were made by three different manufacturers. So they decided to sue all three manufacturers on the premise that we had failed to warn this girl that her eyesight could be impaired.

Well, that's the kind of thing I'm faced with quite regularly. We were sued for $475,000 for a broken leg; 6 weeks later, the boy was out there playing soccer again. We're not even sure it was our shin guard.

I received one in the mail just the other day. It was a claim on a broken leg for a defective shin guard. Now, no one has the shin guard; no one can seem to find it, but I did sell the school some shin guards. Therefore, I am liable.

My chief culprit, so to speak—and it really isn't a culprit, it's just a fact of life—is this helmet that I've brought with me. It's a lacrosse helmet. Most people don't even know what lacrosse is all about. When you mention lacrosse, they think it's something like jai alai, and I can assure them it's not. It's the national game of Canada, believe it or not, not hockey, and it's a very popular sport in the United States. It's the No. 2 spectator sport at West Point, after football, and it's the No. 3 spectator sport at the Naval Academy; after football and basketball, then comes lacrosse. So it's a very popular sport, especially to those who have been exposed to it.

This happens to be a lacrosse stick. This doesn't cause us very many problems, but the helmet does. We are being sued for a number of things on it. One, we've had a mask come loose, and the boy broke his nose. He, in turn, is suing us for his college education, which is about $35,000. He went back into competition playing lacrosse—with somebody else's helmet, I hope—approximately 4 weeks later.

Now, one of our problems is in the warning. They always claim failure to warn. So I print everything on a warning label that I can conceivably think of, hoping to solve any problem; including my telephone number. If they have a problem, they can pick up the phone and call me and I'll answer to it.

Someone mentioned before the problem of technical updating. Well, ours is a very unsophisticated industry. When I was at a lacrosse game, I noticed that one of the boys was talking about the fact that our helmet had a fairly large hole around the ear. And that he could take the end of this stick and jam it into his opponent's ear, causing him a little bit of problems. So I immediately went home and revised the whole thing; I said the heck with it. I'm sure if I'd gone to my lawyers, they would have told me, forget it. Don't even admit there's a mistake. Just go along with what you've been doing. But that's not the way I do business. I want to make sure that the product I put out is the best possible product that I can put out, and I want to be proud of it.

Another solution that people have advanced to us is, take your name off the product. Don't advertise it; don't let them know 10 years from now who made the product. Again, that's not the way I want to do business. I'm proud of the products I sell; I want to be sure that what I give the public is as good as they can possibly get, and the heck with the consequences.

Unfortunately, the consequences are such that there are only two of us that make lacrosse equipment. If we get sued again—we're naked at this point; we have no insurance—we're out of business. Our competitor has no insurance; he would be out of business. And the game of lacrosse is down the tube. There's nobody that's going to go out there and build another helmet. You can't play the game without a helmet. The girls tried it. They do not allow the girls to wear a helmet. They have what's called an invisible bubble around the head, and that bubble is not supposed to be penetrated. Well, my daughter was playing lacrosse and the first game, she called us up and said, "Good news and bad news." The good news was she scored the only goal. The bad news is that she had 15 stitches across the nose.

So again, as the situation evolved, it turns out now that the women's rules committee for lacrosse and the college that a girl was playing at, are being sued because girls aren't wearing helmets. So you can't win either way.

I just don't know how we can handle the situation. I can tell you the consequences. The consequences are that unless we come up with some good, solid legislation that will protect us; define what our obligations are as far as warnings are concerned, define the standards which we have to meet—and are perfectly willing to meet—we can't go and anticipate what's going to happen 5 years from now to the game of lacrosse or any contact sport. My helmets are out there. I'm going to stand behind them. But I'm just in a quandary as to what to do. So I have to go to Congress to come up with answers to the product liability situation.

Thank you very much.

[The prepared statement of Mr. Brine follows:]

STATEMENT OF WILLIAM H. BRINE, PRESIDENT, W.H. BRINE CO.

Mr. Chairman. Thank you for inviting me to appear before your Committee. Before I begin, I would like to congratulate you for holding these hearings, so that the Members of Congress will understand that it is small business which bears the brunt of the products liability crisis. I am very happy that Senator Kasten is here. He certainly has been a stalwart in trying to bring relief to American industry and to the consumer, who is on the paying end of the products liability problem. I am here representing my own company, W.H. Brine, as well as the Sporting Goods Manufacturers Association.

As background, my company was founded by my grandfather in 1922; my brother and I now own it. For years we were an athletic equipment retailer in Boston, selling not only to the public, but also to schools and colleges. In the last 12 years, we have concentrated on the manufacture of lacrosse and soccer equipment, selling to some 3,500 dealers throughout the United States and around the world.

Our company is a small business, in that we have approximately 75 employees: 85% are women, 22% are minorities. Our staff includes All-American lacrosse players and some of the outstanding coaches in the U.S. Our sales are approximately $7 million.

My brother and I have been in this business all of our lives, and we are extremely proud of the fact that we are the number one manufacturer of lacrosse equipment in the world; we also enjoy a 35% market share of the better soccer balls sold in the United States.

Part of our success we attribute to the fact that we spend approximately 20% of our gross profit on the research and development of new products. We have 15 patents on our equipment. We also unconditionally guarantee any product that we sell, to the extent that whatever problem a consumer has with the product, we will supply a replacement at no charge. For instance, if a soccer ball loses air or a lacrosse stick breaks, we will give the consumer a new one, no questions asked. With this kind of a guarantee, we obviously cannot afford to manufacture or sell an inferior product--nor would we.

Now we are faced with a threat to our business which is beyond our ability to handle, that is, product liability. Two years ago our product liability costs were $8,000 for $25 million worth of coverage. Last year, our liability coverage for the same $25 million was $80,000. This year, on December 19th, when our renewal came up, our costs were to be $200,000 for $1 million worth of coverage, rather than the $25 million, and we were only able to receive a quote on a claims-made basis. To obtain a so-called tail on this $1 million worth of coverage to extend beyond the one-year limit, we had to have another $300,000 policy. Even this would not protect us, as it would extend the coverage for two years only. As most of our potential plaintiffs are minors, they have until their majority to file a claim. In the case of a fourteen-year-old boy injured, that means the statute of limitations could run until he was 24, or ten years! It is pretty obvious that no firm of our size can possibly pass onto the consumer this kind of cost.

Who is to blame for this problem? It seems to me that pointing fingers at lawyers, plaintiffs, insurance companies, courts and juries is at best, a useless exercise. However, let me illustrate a couple of the causes. We are presently being sued for $100,000 by a young girl who was playing soccer at a state college in Massachusetts. She kicked the ball, it bounced off the knee of her opponent and hit her in the temple, causing partial impairment of her eyesight. It was a pick-up game with no supervision. They do not have the ball that caused the injury. There was no allegation that the ball was in any way defective, and three weeks after the accident, her lawyer went to the school, found a bag of balls and sued the three manufacturers whose products happened to be in the bag, under the guise that one of the three of us must have supplied the ball and we had failed to warn her that she could be injured with a soccer ball.

Another example is a New York boy who sued us for $475,000 for a broken leg. Again, they never found the shin guard that he was supposed to be wearing at the time, and we were not even sure he was wearing it, let alone being the one we had made or sold. Nevertheless, my insurance company settled for $5,000.

These types of suits have become routine. We (the sporting goods industry) have become a target defendant to the extent that lawyers in the Boston papers have advertised, "Looking for sports injuries." It is obvious that when the insurance underwriters look at our loss ratios with the suits we have had in the past, they are very reluctant to get involved in the future.

However, the distinguished Connecticut jurist, William Burke Lewis, told me that in the last 14 product liability suits that he adjudicated, it was a defendant's verdict in 9 out of the 14 cases. But as I pointed out to him, even as the defendants won in court, they in fact lost, because the defense costs alone could run up to $35,000.

Another cause of the crisis is the small number of companies that are willing to write product liability insurance, and those that do will only take the best risks. From my understanding, they set their rates by the seat of their pants. It appears that our industry's ability to get insurance is not based on what has happened in the past, but based on the insurance company's guess as to what will happen in the future. Sporting goods manufacturing operations today have been red-lined by the insurance industry. There are those companies within the Sporting Goods Manufacturers Association who have never had a claim filed against them, yet their insurance company has hiked the premium to such a degree, in hope that the manufacturer will not be able to afford the cost. In other instances, because of the frivolous lawsuit industry, and a few well-publicized large judgments, insurance companies are withdrawing from the products liability business all together.

The other main cause of the products liability dilemma is the swollen awards for catastrophic injury. As an example, we are being sued for $80 million dollars by a boy who broke his neck while playing lacrosse. There is no helmet designed that can protect a neck from being broken, but because the helmet is closest to the broken neck, we become the target defendant.

The result of our inability to purchase product liability insurance is that one more suit such as the one above will put us into bankruptcy. Our competitors are in the same situation. Without helmets, there will be no men's lacrosse. As a side point, the women's lacrosse will not allow the wearing of helmets, under the theory that the helmet would encourage the wearer to be more aggressive. My understanding is that a college and the women's lacrosse rules committee are being sued for an injury to a player caused by not being protected by a helmet. It seems to be a "Catch-22" situation.

When we deicded to redesign the lacrosse helmet (the present helmet was designed around 1954), we could find no designer who would want to touch the product for fear of his own liability problems. In a number of cases, the manufacturers of the plastic materials that could be used in the helmet specifically told us that they did not want their material used. In today's climate, no one wants to touch this area of protection. We are not only faced with losing a business; America is faced with losing a sport. Mr. Chairman, as the Sporting Goods Manufacturers Association has stated, for American sports, the two-minute warning is about to sound, if Congress takes no action to remedy the present liability situation.

My suggestions to alleviate our problems are based on my business judgment, and not from a legalistic point of view. First, that an expedited claims alternative in a Federal bill should be limited to catastrophic injuries. This would assist the insurance industry in their rate structuring, as well as not open a manufacturer to a universe of claims.

It is the catastrophic injury claims that generate tremendous costs for everyone, with attorneys receiving a greater percentage than the injured person, and insurance companies capable of redeeming losses through higher rates. Most other injuries are minor, and most are covered by a medical plan, whereas the catastrophic injury cases are a "crapshoot" for the plaintiffs and defendants.

Secondly, contingency fee practices should be eliminated, since they provide an incentive for injured persons to bring weak claims and lawyers to extort insurance companies for settlement money.

Third, it is imperative that assumption of risk be a defense for sports injury cases, and that modification, alteration or misuse of a product should void the liability of the manufacturer. As an example, our competitor is being sued for millions when after the game, one player picked up another and dumped him on his head, breaking his neck.

Finally, there ought to be some way for a standard to be devised that would let the manufacturer know he has fulfilled his responsibility to the consumer in providing an adequate warning, even though many manufacturers do not come into contact with the end-users of equipment. The present product liability bill has provisions in it that manufacturers do not have to warn of dangers that are obvious. It would seem to me that sports pose an element of risk, and that for the most part, men, women and children purchase our products for the purpose of being active, aggressive and competitive. It is not the product that poses dangers, but the activity.

I am sure that your Committee will receive many detailed recommendations. Any relief you can give us will be greatly appreciated. Thank you very much, I am prepared to answer any questions.

The **Chairman**. Thank you very much.

It's hard to believe that in a contact sport such as lacrosse there isn't an assumption of liability on the part of the players. It used to be, when I went to law school, the most famous case that we debated was of the baseball that was hit into foul territory and landed on some spectator's head; but you never dreamed of the fact that the players themselves weren't accepting that risk.

Mr. **Brine**. Well, it's very difficult, and I can understand—the catastrophic injury is what really is the problem, as far as we're concerned. The boy goes out and he gets a broken neck; he becomes a quadriplegic. His parents are feeling very guilty about the problem of their having signed a release of liability. And then they are overwhelmed with these large bills. Then they turn and they look to somebody that has deep pockets. Up to this point, the deep pockets have been the manufacturers of helmets; unfortunately, now, it's not the case. Helmet manufacturers are just about at the end of whatever they can do from a financial point of view. And football will go the same way as lacrosse. It may take a little longer, but it will go the same way.

The **Chairman**. Have you ever contemplated getting a release signed insofar as the sale of your equipment is concerned?

Mr. **Brine**. Well, it's a good suggestion——

The **Chairman**. And would it stand up in court, even if you had it?

Mr. **Brine**. It goes through so many hands. I've seen helmets that are 10, 12 years old. I have looked at a stack of helmets that the city of Baltimore turned back to be reconditioned; some of them were 12, 15 years old. And they were cracked; they were just in terrible shape. Once it leaves our place, we have very little control over the product. It goes out in the marketplace, and it can go anywhere. One of these I found—I saw a picture of a fellow who is a rodeo rider, and he was wearing one, because he felt it was the best protection for his broken jaw. Now, I never anticipated that. It's just a difficult situation.

The **Chairman**. Let me ask all of you the same question. In terms of this insurance, assuming the fact that you get it, won't you just be passing it along to your clients or your charges or your players?

Mr. **Brine**. No way, Senator, that I could do that. The helmet—they represent about 4 percent of our sales, and everybody that I talk to, fellow businessmen, say, well, what in the world do you make helmets for? That's just asking for trouble. And I think they're right, but if I don't make them the sport won't exist. And I can't pass it on. We tried to pass some on last year and the schools with their budgets just said no. They didn't buy any helmets. And we're actually in a worse position because the helmets they had were older ones which should have been replaced, and they weren't buying replacements.

Mr. **Lipshie**. Senator, one firm in New York City tried to pass on his increase in costs. We started to get calls from his clients, and then he merged up into one of the bigger firms.

I just don't think that the actual cost of the premium is anything that can be passed on. I think that we're going to have to suffer; we're going to have to eat it.

The **CHAIRMAN**. Ms. Ehrnman.

Ms. **EHRNMAN**. It's difficult to say for certified nurse-midwives. Almost half of the care which is provided by certified nurse-midwives is to the poor. So I don't believe to that segment of the population, we would be able to; I think instead, certified nurse-midwives would go out of business.

The **CHAIRMAN**. Ms. Silverman.

Ms. **SILVERMAN**. Well our program, is already on the upper end of what is generally charged for full-time child care, presently $508 per month. Next year it will go up between 5 and 10 percent. To pass along the insurance costs would amount to $63 per family—or per child, I should say, because some families have two children in our program. We might have to do that. We will be bringing it up at our board meeting, which is next Tuesday night. And I don't honestly know how they're going to feel about that.

There is only so much we can ask of our families. They already contribute to all of our annual fund raising efforts, and in addition last year we began an endowment campaign so that we can become fiscally solvent. I don't know what this will mean long term.

The **CHAIRMAN**. Well, I thank you all for your testimony. I must admit, when you contemplate this problem, you don't contemplate the breadth, if you will, of persons affected. Here we have a sports manufacturer, accountant, midwife, day care center, each one, basically, with the same problem and a very, very severe one.

I know we're going to be hearing from the insurance representatives shortly, but I think anybody would agree—and I only have a few minutes before Senator Bumpers is going to be taking over as the chair—it is a very complex problem. It's very easy, politically, to bop on the heads of the insurance companies, and yet there is an actuarial basis for what they do, or at least there is supposed to be. Maybe yes, maybe no. There is the problem that all of you have, where you provide these services, and they're obviously very necessary in all of your cases. It's probably one of the more interesting problems that I've been confronted with as long I've been in the U.S. Senate.

My former administrative assistant, Diane Bateman, is here. Do you have any necessity for Ms. Ehrnman's professional expertise? Diane is about 1 week away from delivering.

Thank you all very much.

All right. The room will come to order.

The next panel consists of Mr. Robert Young, vice president, Ireland & Bellingar, Inc., Bellingham, WA, representing the Independent Insurance Agents of America; and Mr. James A. Temp of Alexander & Alexander, Green Bay, WI.

Mr. Young, why don't you proceed?

STATEMENT OF ROBERT YOUNG, VICE PRESIDENT, IRELAND & BELLINGAR, INC., BELLINGHAM, WA; REPRESENTING THE INDEPENDENT INSURANCE AGENTS OF AMERICA

Mr. **YOUNG**. Thank you, Mr. Chairman.

As you mentioned, I am Robert Young, vice president of Ireland & Bellingar Insurance Agency in Bellingham, WA. I am also a small businessman and chairman of the Independent Insurance Agents of Washington Legislative Affairs Committee.

As an insurance agent, I represent both companies and the consumer, a position which permits a broader perspective on this and other issues common to the insurance industry. In the brief time I have allotted, I'd like to outline a number of contributing factors to the availability/affordability crisis and suggest some possible remedies.

First, tort trends. There's no getting around the fundamental importance of the tort issue. Whatever else may have contributed to the current crisis and whatever else may be done to seek improvements in insurance markets, risks rendered uninsurable by the courts and law will only be restored by changes in the tort system. Such changes need be neither dramatic nor harmful to our fundamental interest in sustaining a civil justice system both accessible and fair; but a national reevaluation and reform of the concepts of fault, compensation, and evidentiary standards—to name just three—is reasonable, and could go a long way toward restoring the predictability, and therefore the insurability, of certain risks.

The second, reinsurance markets. The big missing link in today's insurance markets is reinsurance, the insurance that insurance companies carry to permit coverage of large risks. The absence of this reinsurance capacity contributes to reduced overall availability and lower limits of coverage. Reinsurers' confidence has been shaken by the unpredictability of contract interpretation. And a return to American markets by reinsurers will be facilitated through use of a new claims-made contract which attempts to limit exposure strictly to the term of the policy. Finally, reinsurance costs, since they are largely uncontrollable, are a big factor in the affordability of insurance now available.

Third, insurance company management. Having acknowledged the effects of tort trends and reinsurance on today's markets, the insurance industry must be clear-eyed and candid about its own contribution to the current crisis. We must recognize that something important has gone wrong with the way insurance companies plan and implement pricing and underwriting strategies, and anticipate market swings which could be better accounted for. The shift in income and profitability natural to the industry and now exaggerated by forces beyond the industry's control are at least aggravated by industry inability or unwillingness to chart for itself a more stable, economically-sensible course and stick to it over time.

Another largely controllable reaction to the real availability crisis in lines of insurance such as environmental liability has been to treat less obviously troubled risks with the same defensive mentality. To be sure, steps must be taken to shore up reserves and protect against future unsustainable losses where the courts and laws have conspired to render risks uninsurable. But not all risks have been similarly undermined, nor all underwriting made as difficult as the celebrated examples of pollution and professional liability.

No amount of change in the tort system or in reinsurance availability will prevent the recurrence of today's crisis if not accompanied by industry reform of pricing and underwriting policies.

Fourth, economic trends. More than most industries, insurance—because of long-term exposure, reserving against future loss, and claims losses—is affected by swings in the general economy. As the criticism of insurance company pricing practices in a high interest rate economy imply, the dramatic drop in interest rates over the past few years has taken its toll on insurance company profitability and surplus. All the more reason for the industry to avoid exaggerating this natural vulnerability by ill-conceived pricing and underwriting decisions.

Finally, the competitive marketplace. Although highly regulated, the insurance industry is a member in good standing of the competitive. relatively-free market. From this fact, a couple of general points should be made. One, short of turning the insurance industry into a public utility of mandated, take-all-comers coverage, it is simply an economic fact of life that not all risks will be insurable at all times, or at low prices; and, two, criticism of and proposed solutions to insurance industry cash flow underwriting bump up against this free market fact: the decision to offset underwriting losses with high investment income was also a decision to pass along to the consumer the benefits, in lower prices, made possible by that market.

With that outline of the multiple causes of the availability/affordability crisis, what can be done to help improve the current market?

At the Federal level, very little. Where the Federal Government has offered insurance directly—flood, crime, riot, crop insurance—the results have been costly and inefficient. Where it has mandated liability limits or created new exposures—such as trucking and pollution liability—the results have been to intensify market distortions. And where it has attempted to impose national standards of coverage, such as health and auto no-fault, Congress has opted for State experimentation.

There are two areas, however, which may require or benefit from a Federal approach. The first is Federal product liability tort reform, probably necessary to account for the flow of products in interstate commerce. The second is amendments to the Federal Superfund law to facilitate the restoration of now unavailable pollution coverages.

In the States, two avenues should be pursued. First, State-by-State tort reform to address in an effective way the tort issues which may have the greatest long-term effects on the insurance markets: costs of litigation, apportionment of fault, punitive damages, and others which may fit into individual State law contexts.

Second, State regulators now have the authority to ensure that insurance rates are neither inadequate, excessive, or unfairly discriminatory. That existing authority should be supported and used. The Independent Insurance Agents of America recommends regulation for company solvency, including the disclosure of financial data, and the strengthening and protection of State guaranty funds. We also support regulations requiring advance notice of mid-term cancellations, nonrenewal, and premium increases.

Finally, in the market, we encourage—and are establishing through many of our State associations—voluntary market assistance plans to help hard-to-place risks find coverage. Also in the market, the new industry claims-made form may help provide coverage where there is none now, and it should be given a chance to work.

Mr. Chairman, I thank you. If you have any questions, I would be very happy to answer them.

[The prepared statement of Mr. Young follows:]

STATEMENT OF ROBERT YOUNG, ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS OF AMERICA, INC., BEFORE THE SENATE SMALL BUSINESS COMMITTEE

Mr. Chairman, I am Robert Young, Vice President of the Ireland and Bellingar Insurance Agency in Bellingham, Washington. I am also Chairman of the Independent Insurance agents of Washington State Legislative Affairs Committee. As an insurance agent, I represent both insurance companies and the consumer—a position which permits a broader perspective on this and other issues otherwise common to the insurance industry.

In the brief time allotted, I'd like to outline a number of contributing factors to the availability/affordability crisis and suggest some possible remedies.

Tort Trends: There's no getting around the fundamental importance of the tort issue. Whatever else may have contributed to the current crisis, and whatever else may be done to seek improvements in insurance markets, the long-term insurability of risks rendered uninsurable by the courts and law will only be restored by changes in the tort system. Such changes need be neither dramatic nor harmful to our fundamental interest in sustaining a civil justice system both accessible and fair. But a national reevaluation and reform of the concepts of fault, compensation, and evidentiary standards—to name just three—is reasonable, and could go a long way toward restoring the predictability, and therefore the insurability, of certain risks. Two more points about tort reform: (1) tort reform is a necessary but not sufficient response to the insurance availability and affordability crisis, and (2) it is not only an insurance issue. The country's tort system needs reform quite apart from the direct effect such changes might have on insurance markets.

Reinsurance Markets: The big missing link in today's insurance markets is reinsurance: the insurance that insurance companies carry to permit coverage of large risks. The absence of this reinsurance capacity contributes to reduced overall availability and lower limits of coverage. Reinsurers' confidence has been shaken by the unpredictability of contract interpretation. And a return to American markets by reinsurers—again, we are advised across the Atlantic—will be facilitated through use of a new "claims made" contract which attempts to limit exposure strictly to the term of the policy. Finally, reinsurance costs, since they are largely uncontrollable, are a big factor in the affordability of insurance now available.

Insurance Company Management: Having acknowledged the effects of tort trends and reinsurance on today's markets, the insurance industry must be clear-eyed and candid about its own contribution to the current crisis. We must recognize that something important has gone wrong with the way insurance companies plan and implement pricing and underwriting strategies, and anticipate market swings which could be better accounted for. The shift in income and profitability natural to the industry and now exaggerated by forces beyond the industry's control are at least aggravated by industry inability or unwillingness to chart for itself a more stable, economically sensible course and stick to it over time. Product underpricing when times were good, followed by ill-conceived efforts to make up lost ground to quickly, have almost certainly made a bad situation worse.

Another largely controllable reaction to the real availability crisis in lines of insurance such as environmental liability, has been to treat less obviously troubled risks with the same defensive mentality. To be sure, steps must be taken to shore up reserves and protect against future, unsustainable losses where the courts and laws have conspired to render risks uninsurable. But not all risks have been similarly undermined, nor all underwriting made as difficult as the celebrated examples of pollution and professional liability. As my national association's President, Mr. Richard Taylor, recently remarked: "Underwriting is the science of trying to find a way of writing a risk—not trying to find a way to get out of writing it. It seems now the underwriters are trying in most cases to find a way to get out of writing a new piece of business." No amount of changes in the tort system or in reinsurance availability will prevent the persistent recurrence of today's crisis if not accompanied by industry reform of pricing and underwriting policies.

Economic Trends: More than most industries, insurance—because of long-term exposure, reserving against future loss, and claims losses—is affected by swings in the general economy. As the criticism of insurance company pricing practices in a high interest rate economy imply, the dramatic drop in interest rates over the past few years have taken its toll on insurnace company profitability and surplus. All the more reason for the industry to avoid exaggerating this natural vulnerability by ill-conceived pricing and underwriting decisions.

Claims Losses: Statistical arguments are always slippery, but insurnace industry statistics show an industry-wide net operating loss last year for the first time ever—and we believe them. Others' statistics reach different conclusions, and, beyond a rudimentary level of understanding quickly reached by those of us unschooled in the actuarial sciences, it is frankly difficult to know what ultimately will come of this furious debate. As an insurance agent, I know what I see in the market, and I see many of my companies hurting financially—in part from the self-inflicted wounds of price-cutting a few years back, but in part too from economic circumstances beyond their control. Until an objective, knowledgeable statistician can be called in to sort out all the numbers, the existing statistical evidence should signal caution in drawing firm conclusions or pursuing policy decisions which could further weaken an already financially strapped industry.

Competitive Marketplace: Although highly regulated, the insurance industry is a member in good standing of the competitive, relatively free market. From this fact, a couple of general points should be made: (1) short of turning the insurance industry into a public utility of mandated, take-all-comers coverage, it is simply an economic fact of life that not all risks will be insurable at all times, or at low prices, and (2) criticism of, and proposed solutions to, insurance industry "cash-flow" underwriting bump up against this free market fact: the decision to offset underwriting losses with high investment income was also a decision to pass along to the consumer the benefits, in lower prices, made possible by that market. What would public reaction have been if at the time of record interest rate investment income the insurance industry had not competitively lowered the price of its product? These are quirks and complexities of the competitive marketplace which must be taken into account.

With that outline of the multiple causes of the availability/affordability crisis, what can be done to help improve the current market?

At the federal level, very little. Where the federal government has offered insurance directly (flood, crime, riot, crop), the results have been costly and inefficient. Where it has mandated liability limits or created new exposures (trucking, pollution liability), the results have been to intensify market distortions. And where it has attempted, thus far, to impose national standards of coverage (health and auto no-fault), the prospect of raising to a universal level the potential high costs and market dislocations which might otherwise be limited by state experimentation has been enough to dissuade past congresses. There are two areas, however, which may require or benefit from a federal approach. The first is federal product liability to tort reform, probably necessary to account for the flow of products in interstate commerce. The second is amendments to the federal Superfund law (CERCLA) to facilitate the restoration of now unavailable pollution coverages by eliminating retroactive liabilty for risks never contemplated in pre-CERCLA insurance contracts, and by modifying the joint and several liability now imposed under CERCLA.

In the states, two avenues should be pursued. First, state-by-state tort reform, to address in a modest but effective way the tort issues which may have the greatest long-term effects on insurance markets: costs of litigation, apportionment of fault, punitive damages, and others which may fit into individual state law contexts.

Second, state regulators now have the authority to ensure that insurance rates are neither inadequate (too low), excessive (too high), or unfairly discriminatory. That existing authority should be supported and used. Specifically, IIAA recommends and supports regulation for company solvency, including disclosure of finanical data and the strengthening and protection of state guaranty funds. We also support regulations requiring advance notice of mid-term cancellation, non-renewal, and premium increases.

Finally, in the market, we enourage, and are establishing through many of our state associations, voluntary, market assistance plans to help hard-to-place risks find coverage. Also in the market, although not universally endorsed by our state associations, and still an unknown quantity in terms of marketability and restoration of reinsured participation in American markets, the new, industry "claims-made" form may help provide coverage where there is none now, and should be given a chance to work.

Mr. Chairman, insurance availability is complex, and has no simple causes or cures. Insurance agents stand ready to help you and other members of congress better understand this issue, and pursue short and long-term remedies which reflect the public's interest in having a competitive, stable, financially sound insurance industry. Thank you—I'd be happy to answer your questions.

Senator BUMPERS [acting chairman]. Have you already testified, Mr. Temp?

Mr. TEMP. No, I haven't.

Senator BUMPERS. Please proceed.

STATEMENT OF JAMES A. TEMP, MANAGING VICE PRESIDENT, ALEXANDER & ALEXANDER SERVICES, INC., GREEN BAY, WI; ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE BROKERS

Mr. TEMP. Mr. Chairman, members of the committee, I am Jim Temp, managing vice president of the Green Bay, WI, office of Alexander & Alexander. A&A is the second largest insurance brokerage company in the world. We also operate in a decentralized manner and have offices in 113 American cities.

I am here today representing our trade association, the National Association of Insurance Brokers, NAIB. I appreciate the opportunity to testify.

The NAIB is a trade association of commercial insurance brokers who, on behalf of their clients, administered over $30 billion in premiums in 1985. Our clients are individuals, businesses of all sizes, and professional people, as well as municipalities and State governments, schools, religious organizations, and other nonprofit entities. Their financial risk exposures range from thousands of dollars to hundreds of millions of dollars.

The broker's most important function is to protect the assets of our clients. In doing this, we employ a wide range of skills that combine a broad knowledge of the insurance market with experience in risk management and loss control programs.

Brokers understand the insurance marketplace because we grapple with finding our clients available and affordable insurance products every day. And I can tell you that we have a very serious capacity problem in today's market.

I recently returned from my company's annual meeting, where I heard my colleagues tell some real horror stories. What we are finding is that while the liability crisis is not affecting every place and everyone in the same way, it is touching many segments of our society; and from what I hear from other brokers, it is not getting any better.

We have been fortunate in Green Bay. Our office handles both large and small businesses which, among others, include a large paper company, local stores, and our city's pride, the Green Bay Packers. So far, we have been able to satisfy about 95 percent of our clients' risk management requirements. This hasn't been accomplished without problems and, obviously, without sizable rate increases. Finding umbrella coverage for our clients, for example, is extremely difficult in this marketplace. In Green Bay, the small grocery stores and retail stores are not a problem for us. Clients with medium-sized businesses have been the ones hardest hit, particularly in the product liability area.

A typical example is a client who manufactures converting machinery for the paper industry. They have been our client for a number of years. They built a machine in 1946 which has had three owners. One of the owners substantially modified the design, moving the operator's position from in front of the machine to the side of the machine. This change made it simple and easy for the operator—in an instant when a piece of paper was jammed in the gears—to reach in and pull it out. In the process of doing that, he took off the tips of three fingers. Why he didn't turn the machine off in an attempt to extract that piece of paper, no one seems to know.

The operator sued our client, even though the machine had been sold 40 years prior. The operator was awarded $380,000, a very large sum of money for a small business.

Fortunately in this case, we were able to put together a self-insurance program to keep the company in business. In addition, though, they had to accept a large self-insured retention.

We credit our success in meeting our clients' insurance needs with several factors. We have excellent relationships with stable underwriters who have good ratings and reputations. We have worked with many of our clients for years and we know their risk exposures and loss histories. And perhaps there is an advantage in a small community where people know each other and business relations are built upon trust as well as good service. But even with all the skills of brokering, if the capacity is not available at any cost, we can't make it magically appear.

I'm afraid that brokers are finding that capacity is not available or very limited in some areas. Small businesses—doctors, restaurants, day care centers, nursing homes, and bars, to mention a few—are reporting extreme difficulty in locating liability insurance. Many must pay dramatic premium increases, if they can find insurance at all.

What we are experiencing is a general tightening in the market as insurers try to recoup their recent losses. In some instances, insurers are deciding that the risk potential in certain lines of business are too uncertain to be insurable, and are simply pulling out of the market. When this happens, it can be very difficult to find a replacement insurer.

The range of risk management options for small businesses outside traditional insurance is limited. Methods being used by some larger companies—captives and group insurance pools—may be too expensive and difficult to administer for small firms. As a result, smaller companies may buy less coverage or, as we've heard here many times this morning, go bare. Because they operate on a narrower profit margin, obviously, one large loss could easily wipe them out.

But it should be emphasized that loss control and risk management programs will help any company or organization reduce its financial exposure. Reducing risks, while always desirable, can make a critical difference to a business in today's environment because it increases the options for insurance coverage.

The liability crisis is not just an insurance problem; it is a national problem. Small businesses, of course, are not the only ones being affected; schools, municipalities, large companies, and most professionals are feeling the impact.

As consumers we ultimately pay the cost in higher prices for products and services, and in the loss of technologies that improve the quality of our lives, or actually save our lives.

Factors that have contributed to the crisis include courts expanding and redefining theories of liability to cover risks never contemplated by the insurer; cash flow underwriting practices encouraged by high interest rates; withdrawal of world reinsurers from the market; and cultural attitudes that encourage settlement of disputes in court rather than over the back fence.

While we are beginning to come to terms with the causes and the consequences of the liability problem, the answers are coming with a little more difficulty. The issues are complex and offer no easy solutions for either policy makers, the insurance consumer, or the industry. But it is clearly in our best interest to seek ways to stabilize the insurance market and restore predictability to insuring risks.

Mr. TEMP. No. 1, we should examine our civil justice system to determine what impact it is having on the insurance market, on our economy in general, and on our ability to resolve our disputes.

No. 2, we should examine the insurance cycle to find ways to ease the extreme market swings without interfering with the free market.

No. 3, we should expand the Risk Retention Act to include risks in addition to product liability.

And lastly, provide tax equity for loss reserves for self-insurers.

Neither the insurance industry, business, Government, lawyers, or the public is completely blameless in bringing us to the place we are today. And it will take the concerted effort of us all to come to terms with the problem. Our time might be better spent focusing on what we might do together to solve the problem.

Mr. Chairman, I commend you and the committee for taking the time to examine some of the ways we can resolve this very serious situation.

Thank you very much.

[The prepared statement of Mr. Temp follows:]

TESTIMONY OF JAMES A. TEMP
ON BEHALF OF
THE NATIONAL ASSOCIATION OF INSURANCE BROKERS

Mr. Chairman, members of the committee I am Jim Temp, managing vice president of the Green Bay, Wisconsin office of Alexander and Alexander (A&A). A&A is the second largest insurance brokerage company in the world. We also operate in a decentralized manner and have offices in 113 American cities.

I am here today representing our trade association, the National Association of Insurance Brokers (NAIB). Accompanying me is Barbara Haugen, Director of Federal Affairs for NAIB.

I appreciate the opportunity to testify.

The NAIB is a trade association of commercial insurance brokers who, on behalf of their clients, administered over $30 billion in premiums in 1985. Our members include large international brokerage companies as well as regional and local firms.

Our clients are individuals, businesses of all sizes and professional people, as well as municipalities and state governments, schools, religious organizations and other nonprofit entities. Their financial risk exposures range from thousands of dollars to hundreds of millions of dollars.

The brokers' most important function is to protect the assets of our clients. In doing this, we employ a wide range of skills that combine a broad knowledge of the insurance market with experience in risk management and loss control programs.

Brokers understand the insurance marketplace because we grapple with finding our clients available and affordable insurance products everyday. And I can tell you that we have a very serious capacity problem in today's market.

I recently returned from my company's annual meeting where I heard my colleagues tell some real horror stories. What we are finding is that while the liability crisis is not affecting every place, and everyone in the same way, it is touching many segments of our society -- and from what I hear from other brokers, it is not getting any better

We have been fortunate in Green Bay. Our office handles both large and small businesses, which among others include a large paper company, local stores, and our city's pride -- the Green Bay Packers.

So far, we have been able to satisfy about 95% of our clients' risk management requirements. This hasn't been accomplished without problems and without some rate increases. Finding umbrella coverage for clients, for example, is much more difficult than in the past.

In Green Bay the small groceries and retail stores aren't the problem for us. Clients with medium sized businesses have been the ones hardest hit, particularly in the product liability area.

A typical example is a client who manufactures converting machinery for the paper industry. They have been our client for a number of years.

They built a machine in 1946 which has had three owners. One owner substantially modified the design, moving the operator's position from the front of the machine to the side. This change made it easier for the operator to reach into the gears to pull out jammed paper.

Without turning off the machine, one operator attempted to remove the jammed paper and lost the tips of three fingers. Why he didn't turn the machine off first we don't know.

The operator sued our client even though they had sold the machine almost 40 years ago. The operator was awarded $380,000, -- a large sum for a small business.

Fortunately, we were able to put together an self-insurance program to keep the company in business. However, they had to accept a large self-insured retention.

We credit our success in meeting our clients' insurance needs with several factors. We have excellent relationships with stable underwriters who have good ratings and reputations. We have worked with many of our clients for years, and we know their risk exposures and loss histories.

And perhaps there is an advantage in a small community where people know each other and business relations are built upon trust, as well as good service.

But even with all the skills of brokering, if the capacity is not available at any cost, we can't make it magically appear. I am afraid that brokers are finding that capacity is not available or very limited in some areas.

Small businesses -- doctors, restuarants, day care centers, nursing homes and bars, to mention a few -- are reporting difficulty in locating liability insurance.

Many must pay dramatic premium increases, if they can find insurance at all.

The Wall Street Journal recently reported that a ski resort in Pennsylvania raised the price of ski-lift tickets an average of 25% to compensate for a 600% increase in its premium. At the same time its deductible increased from $250 to $300,000.

Such examples are disturbing, and it is understandable why the business community and the public are alarmed. It is also difficult for those involved to understand the relationship between their premium increases and the insurance market generally -- especially if their businesses have a good loss record.

What we are experiencing is a general tightening in the market as insurers try to recoup their recent losses.

In some instances, insurers are deciding that the risk potential in certain lines of business are too uncertain to be insurable and are simply pulling out of the market.

When this happens, it can be very difficult to find a replacement insurer.

The range of risk management options for small businesses outside traditional insurance is limited. Methods being used by some larger companies -- captives and group insurance pools -- may be too expensive and difficult to administer for small firms.

As a result smaller companies may buy less coverage or 'go bare.' Because they operate on a narrower profit margin, one large loss could easily wipe out a small business.

But it should be emphasized that loss control and risk management programs will help any company or organization reduce its financial exposure. Reducing risks, while always desirable, can make a critical difference to a business in today's environment because it increases the options for insurance coverage.

The liability crisis is not just an insurance problem it is a national problem. Small businesses, of course, are not the only ones being affected: schools,

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municipalities, large companies and many professionals are feeling the impact.

As consumers, we ultimately pay the cost in higher prices for products and services, and in the loss of technologies that improve the quality of our lives or save them.

Factors that have contributed to the crisis include:

-- courts expanding and redefining theories of liability to cover risks never contemplated by the insurer;

-- cashflow underwriting practices encouraged by high interest rates;

-- withdrawal of world reinsurers from the market; and

-- cultural attitudes that encourage settlement of disputes in court rather than over the back fence.

While we are beginning to come to terms with the causes and the consequences of the liability problem, the answers are coming with a little more difficulty.

The issues are complex and offer no easy solutions for either policymakers, the insurance consumer or the industry. But it is clearly in our best interest to seek ways to stabilize the insurance market and restore predictability to insuring risks.

I will briefly mention a few issues that merit your consideration. And if there is no objection, Mr. Chairman, I would like to subm . for the record additional material explaining NAIB's position on these and other issues concerning the liability crisis.

We should:

o examine our civil justice system to determine what impact it is having on the insurance market, on our economy in general, and on our ability to resolve our disputes;

o examine the insurance cycle to find ways to ease the extreme market swings without interfering with the free market;

o expand the Risk Retention Act to include risks in addition to product liability; and

o provide tax equity for loss reserves for self insurers.

There has been much finger-pointing over who's to blame for the crisis. It reminds me of the old Laurel and Hardy episodes which inevitably ended with Oliver reminding Stanley, "Another fine mess you've gotten us into."

Neither the insurance industry, business, government, lawyers or the public is completely blameless in bringing us to the place we are today. And it will take the concerted effort of us all to come to terms with the problem.

Our time might be better spent focusing on what we might do together to solve the problem. Mr. Chairman, I commend you and the committee for taking the time to examine some of the ways we can resolve this very serious situation. Thank you.

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APPENDIX A

EXAMPLES OF BROKERS RESPONDING TO AVAILABILITY/AFFORDABILITY PROBLEMS

° Building on years of experience, brokers have developed sophisticated financial services for their insurance clients. These include loss forecasting and cash flow analysis for financial exposures, as well as other analytical and computerized services.

* * * * *

° Companies in Missouri face some of the highest insurance costs in the U.S. Following the Hyatt Hotel disaster in Kansas City, many juries do not think twice about million-dollar plaintiff awards. An international medical insurer, the only company in its specific market, excludes only one city in the entire world from coverage: Kansas City.

Brokers, insurers, hospitals, doctors and trial lawyers recognized the alarming legal trends in Missouri, and earlier this month, addressed the problem with a tort reform bill. The bill was the first passed by the 1986 Missouri legislature and has already been signed by Governor Ashcroft. Each segment of the broad-based coalition made some compromises, with the resulting legislation creating a monument to everyone.

* * * * *

° New Jersey is one of the most difficult states for insurance buyers. Brokers, using their market leverage, are convincing some insurers to resume sale in the state by identifying and offering the most preferable risks--those companies with exemplary safety records who do not deserve to pay the skyrocketing costs.

* * * * *

° When Suffolk County, New York could not afford its quadrupled insurance costs, a national broker established loss control and insurance claims services for the county to self-insure as efficiently as possible. In cases such as this, brokers are not selling an insurance product at all, but strictly its services.

* * * * *

° In St. Louis, one broker helped St. Luke Hospital, St. Anthony Medical Center and St. Louis Medical Center arrange coverage through self-insured trusts. When faced with recalcitrant insurers, innovative brokers often create pooled or group arrangements.

APPENDIX B

UNDERWRITERS REPORT

SEPTEMBER 26, 1985

'Civil Justice Reform' Priority Issue For NAIB

SAN FRANCISCO — The National Association of Insurance Brokers last week called for reform of the civil justice system to provide fairer and more efficient handling of liability disputes.

At its quarterly meeting here, members of the NAIB board adopted the following resolution:

"The NAIB board of directors recognizes that the current state of America's civil justice system frequently does not serve the interests of the parties involved or the American public.

"The NAIB board recognizes that significant efforts are under way to reform the civil justice system. Reforms are required so that all parties will be treated equitably, transaction costs can be reduced and the public will be better serviced.

"Therefore, the board of directors of the NAIB resolves that civil justice reform shall be the Association's priority public policy issue for 1985-86. NAIB will identify and study specific proposals and promote those which the executive committee and board believe are most likely to lead to a more efficient and equitable system."

Moore Comments

NAIB President Dr. Robert H. Moore, senior vice-president of Alexander & Alexander, commented: "Our present system of resolving disputes is costly, time-consuming and inconsistent; and the nation as a whole is the loser. The situation has reached the crisis stage where the insurance industry is forced to pass along extraordinary added costs in the form of rate increases.

"On many classes of business, risk-takers are justifiably inhibited from providing needed insurance protection at affordable prices. Consequently, many coverages have been sharply curtailed. Even when coverage is available, the premiums are becoming unaffordable."

Dr. Moore pointed out that "for years, businesses and individuals have turned to their brokers for solutions in managing risks. It is only natural and appropriate that this Association apply its members' creativity and expertise to address the current crisis.

"Private industry must help develop more consistent, effective and efficient systems to compensate injured persons," Mr. Moore explained.

Insurance
ADVOCATE
September 28, 1985

INSURANCE LAW REVIEW

The Implications Of Toxic Tort Liability for Industry

By Robert H. Moore

MOST OF YOU ARE AWARE of the escalating crisis in the availability of insurance. What you may not know is that it will become considerably worse in the months ahead.

The facts are that many organizations will not be able to find adequate coverage at any price.

Some are already being affected. Coverages for medical and legal malpractice, daycare, asbestos removal & abatement, vaccine development, municipal governments, and hazardous waste cleanup are in jeopardy.

Businesses of all sizes are feeling the impact of the shortage. Many have realized premium increases ranging from 25 percent to 300 or 400 percent for property and liability coverage.

In a typical case, earlier this year—Olin Corporation, a major U.S. chemical company, paid twice as much for half as much general liability coverage as it bought last year.

Small businesses are being squeezed as well. A New York car dealership owner saw his insurance increase from $40,000 to $110,000 at his last renewal.

The declining availability and rising cost of liability insurance could have a profound affect on the ability of American industry to produce new products and develop new technologies.

Other effects will inevitably include the withdrawal or consolidation of some markets, severe economic pressures for companies, and further erosion of the trading position of U.S. firms in the world marketplace.

So what has happened to the availability and cost of commercial insurance? Just months ago, we brokers could get our clients the coverages they needed at affordable prices.

From the perspective of the insurance industry—especially the international reinsurers—a major cause of the current crisis is the tendency of the American courts to see insurance as the deep pocket which will solve all problems.

Peter Miller, chairman of Lloyd's of London, reports that "the uncertainty engendered by the vagaries of the American legal system" has cast doubt on the continuing availability of insurance capacity—capacity which will be required to insure the enormous technological advances on which the future competitiveness of the U.S. economy depends.

Unlike Mr. Miller, I would not go so far as to lay the insurance crisis at the court's door.

While liability doctrines in American courts have contributed to the crisis, our industry must also bear part of the blame. As an insurance broker, it is my intent to offer a balanced view of these problems. Brokers are typically the men and women in the middle.

Our livelihood depends on our ability to represent the insurance needs of the American public. We operate as insurance buyers—primarily in the property and casualty areas.

In 1984, members of the National Association of Insurance Brokers wrote and administered over $25 billion in premiums. Our companies range in size from large international houses, such as Alexander & Alexander, to regional and small local firms. Our business is to assist our clients, commercial as well as non-profit, in solving their problems and meeting their risk management needs.

In addressing the issue of compensating toxic tort victims, my remarks today will reflect the experience of brokers as intermediaries in the insurance process.

Although the media has only recently discovered the crisis, some insurance leaders have been speaking out about the industry's problems for months. Jack Bogardus, Alexander & Alexander's chairman, told his stockholders last spring that the industry was entering an explosive and critical period—a period brought on by a convergence of problems.

Mr. Bogardus candidly characterized one problem as "self induced" by U.S. and world underwriters. The underwriters had, in recent years, forsaken their traditionally conservative underwriting practices and taken up "cash flow" underwriting—a practice encouraged by high interest rates. Companies found they could underwrite at a loss and still make money by short term investment of their premium income.

For six consecutive years, from the late 70's until 1984, companies competed for business by cutting prices below adequate cost levels.

Mr. Moore is president of the National Association of Insurance Brokers. He is also senior vice president of Alexander & Alexander. He delivered this address on September 18, 1985 as part of a day-long forum on "Compensating Toxic Tort Victims," sponsored by the Brookings Institution, in Washington, D.C.

Consequently, consumers benefited from premium rates in just about every area of insurance. The down side is—it couldn't last—prices had to go up. And, as we know, the market has now turned with a vengeance.

A second force fueling the insurance crisis has been the proliferation of liability-related claims. The burden of funding claims for almost any disease, work-related or otherwise, or for any product irrespective of how it is used or when it is manufactured, has been dumped in the lap of the insurance industry.

Criteria such as negligence, the former state of scientific knowledge or the wording of insurance contracts are often being disregarded.

Such complex socio-political and economic forces as I have just sketched underlie today's crisis.

We have entered an era when many insurance providers have decided that the costs and risks of insuring American liability have become too great.

Lloyd's of London announced a few days ago that its underwriting losses for 1982 were $304 million—the worst in its THREE CENTURIES of risk-taking. The losses stemmed primarily from general liability claims in the U.S. While accounting for only 12 percent of Lloyd's business, these liabilities were responsible for almost all of the 1982 losses.

Lloyd's chairman Peter Miller warned, "The figures speak for themselves. We're saying, as a friend, we've come to the end of the road on this class of business."

Earlier this summer at the U.S. brokers' annual meeting, Miller said, "We insurers have little faith that we shall receive justice at the hands of the American legal system."

SOME EXAMPLES

To gain some perspective on what Peter Miller and others are referring to, let's consider a few examples.

- The asbestos industry and its insurers may have to pay out billions of dollars between now and the end of the century to victims of asbestosis and related diseases.
- Love Canal litigants are seeking $400 million in damages.
- The Three Mile Island nuclear reactor accident in 1981 resulted in hundreds of lawsuits—many of which are seeking up to $5 million each.
- Union Carbide has suits filed against it ranging from $15 billion to $50 billion as a result of the Bhopal, India tragedy last year.
- A.H. Robins and manufacturers of DES are also facing thousands of lawsuits involving hundreds of millions of dollars.

Insurance requires an ability to anticipate future liabilities. And what concerns insurers today is that they can no longer reasonably anticipate their future liabilities. Nor can they count on reasonably consistent interpretations of the insurance contract by the courts.

Looking for the deep pocket to spread the costs of compensating the injured, courts have developed ever more inventive theories of liability.

It isn't the traditional liabilities like air crashes and hurricanes that are threatening the solvency of the industry.

It is the long-tail, long-latency blind risks that will bankrupt insurance companies. Risks that the insurer was unaware of—risks which the insurers did not calculate in establishing their premiums.

From the often myopic perspective of the international reinsurers, it looks as if the American courts have decided that just about any injury should be compensated through the tort process regardless of responsibility or cause.

Let me give you an example of a product liability case to demonstrate how far we have taken this concept.

- A 41-year-old body builder entered a foot race. To demonstrate his prowess, he strapped a refrigerator on to his back with special restraints. When one of restraints slipped during the race, he was injured. He sued, among others, the makers of the restraints. The jury awarded him $1 million.

Compensating the injured may be a desirable public policy goal—but it defies the economics of insuring risks.

When the deep pocket approach is applied to a handful of cases, the U.S. economy can tolerate the inefficiency of the tort system. When it involves tens of thousands of cases, society at large begins to feel the impact.

Insurance has become the medium through which this impact is transmitted to consumers and industry at large.

The American legal system is making it increasingly difficult for the insurance industry to make available the capacity needed to insure the enormous technological advances of the eighties and nineties.

Technological developments that are financially sound and in the public interest are, from a risk standpoint, often pure gambles in light of uncertainty in the courts.

Congress has on occasion recognized the need to balance public interests by shielding from the tort process technologies considered crucial to the public's present or future health and safety.

It is not surprising that Congress has had to provide tort immunities, particularly for those who would develop technology to bring us new vaccines.

The compulsory insurance requirements of both RCRA and Superfund (CERCLA) are in jeopardy because of the unavailability of coverage for environmental impairment liability.

The question before us is—how we are going to handle the future?

DES, Asbestos, Agent Orange, Dalkon Shield, Bhopal, Love Canal, Three Mile Island. Considering what is looming on the horizon, these cases may only portend what is to come.

In its attempt to clean up the environment, EPA has identified 786 toxic waste dumps across the country and estimates that 2,500 sites may be eventually included on the list.

Who knows what damages will be found?

New products with great promise for improving our quality of life are being developed everyday. How can we ensure that business will be able to continue producing these products?

How do we balance the public benefits with the risks involved?

We are faced with some tremendously difficult social policy questions. They would give King Solomon a headache. And like King Solomon, we can't simply divide the child in two.

Our policy solutions must address a wide range of public concerns. We must closely examine the trade-offs.

We must develop methods for compensating the injured in a less costly, inefficient and haphazard way. We must also consider if the huge damages being awarded by the courts today will prevent us from compensating those deserving compensation in the future.

Consumers have a right to a system that offers a speedy and certain recovery for injury. Organizations, profit and non-profit, have a right to reasonable certainty about their potential liabilities.

Both will be better served by avoiding exorbitant legal fees and transaction costs which sometimes are in excess of 50 percent of total payments.

What will the economic impact be if the current trends continue unabated? Insurance companies and their reinsurers will continue to withdraw, or dramatically restrict, their participation in high risk markets. They will increasingly introduce a claims-made basis for claims and institute overall limits.

The growth and technological advance of some industries will be damaged and the survival of others will be in jeopardy. Large companies, when they can afford to, will self insure. Many smaller companies may be driven out of business.

Pressures will grow for Congress to step in. This will mean the increased likelihood of greater federal involvement in the insurance industry and federal preemption of state law.

In the midst of such volatile and uncertain pressures, brokers have a responsibility to their clients to work for acceptable and affordable solutions to some of these problems.

And we believe this can best be done in an environment which minimizes finger pointing—whether it is at trial lawyers, insurance companies, the troubled manufacturers, or at those who are injured.

The problems are national and international in nature. Only joint efforts by coalitions of those involved will lead to useful resolution in the years ahead.

INSURANCE ADVOCATE
NEW YORK, NY

November 16, 1985

NAIB Asks Commissioners To Make Financial Data On Insurers More Readily Available To Producers

WASHINGTON, D.C.—The board of directors of the National Association of Insurance Brokers (NAIB) has asked the National Association of Insurance Commissioners (NAIC) to make financial data on insurers more readily available to brokers and agents.

In a letter to the commissioners' association, NAIB President Robert H. Moore, senior vice president of Alexander & Alexander, said information on company solvency is an immediate concern of NAIB.

"Our members share the growing concern of many in our industry who believe the solvency of insurance companies should receive increasingly close scrutiny. In light of current market conditions, insurance buyers must have timely and accurate information in order to make knowledgeable decisions about their insurance and risk management options," said Moore.

"Consequently, NAIB requests that data, including quarterly reports, be made more generally available by insurance regulators through NAIC and its reporting system. We believe that ready access to such information on a quarterly basis can provide greater protection to the insurance buyer."

Moore told NAIC President Bruce W. Foudree that NAIB's members represent commercial risks throughout the country who face difficult risk management choices. "So that brokers can more adequately serve their clients, we believe all relevant data should be made public on a timely and regular basis."

"We support the NAIC in its efforts to protect the insurance buyer, as well as the insurance provider," said Moore. "NAIB stands ready to assist insurance regulators in any instance where brokers' expertise can be helpful."

The Journal of Commerce
AND COMMERCIAL
A Knight-Ridder Newspaper

Wednesday, December 18, 1985

INSURANCE

Liability Crisis Viewed Devastating to Economy

NEW YORK — "We are entering the most volatile period in the history of the insurance industry," Robert H. Moore said to the quarterly board meeting of the National Association of Insurance Brokers.

The NAIB speaks for brokers who in 1984 handled property and casualty insurance with a premium value of over $26 billion.

Mr. Moore, NAIB president and senior vice president of Alexander & Alexander, the New York-based brokers, reported, "the liability crisis is placing devastating economic pressures on our clients who come from a wide variety of professions, industries and organizations. We are on the verge of an unprecedented debate over the very nature of our industry and its role in the economic life of the nation.

"We must face the prospect that the real world dynamics of our industry and the complex needs of our clients could quickly be obscured if we do not work to establish the parameters of a serious and thoughtful public dialogue. Brokers must articulate their role in creating a more efficient and economical marketplace."

Mr. Moore warned, 'in the environment of 1986, this will not be an easy task. Nevertheless, our function as consumer representatives, our role as intermediaries, must not be lost in the firestorm of the debates which are to come."

He said that "the brokers" primary responsibility is to protect client assets in today's difficult market. Both large and small businesses as well as non-profit organizations require appropriate coverage for their people, products and property. "The basic role of brokers must be made clear. It is our professional responsibility to:

- Analyze a client's financial exposure.
- Suggest methods for reducing risks.
- Fairly assess insurance needs.
- Develop the relevant coverage.
- Thoroughly explain payment options.
- Advise on claims procedures.
- Assist in handling claims."

HOUSTON BUSINESS JOURNAL DECEMBER 30, 1985

12/30/85

Litigation pushes up insurance costs

As courts redefine and expand theories of liability, and insurance costs escalate, the insurance broker's role as an intermediary between the insurance buyer and the insurer is receiving more public attention. In the following commentary, Robert H. Moore, president of the National Association of Insurance Brokers and senior vice president of Alexander & Alexander Services Inc., discusses the insurance broker's changing role.

The broker's primary responsibility is to protect client assets. Both large and small businesses as well as non-profit organizations require coverage for their people, products and property. Brokers possess the specialized expertise and resources to evaluate the financial exposures that result from corporate and organizational activity. To meet these needs, brokers typically:

- Analyze a client's financial exposure.
- Suggest methods for reducing risks.
- Fairly assess insurance needs.
- Develop the relevant coverage.
- Thoroughly explain payment options.
- Advise on claims procedures.
- Assist in handling claims.

Brokers are not simply concerned with the most inexpensive coverage, they assess the most approproate insurance market — the one best able to respond to the risk.

Placement of insurance coverage has become increasingly difficult in 1985. For the first time in six years, business insurance consumers are facing a market which is constricting dramatically.

Insurance industry capacity to cover risks is shrinking, and premiums are rising. The availability and affordability of insurance reflects broad social, political and cultural dynamics in our society. As informed problem-solvers, representing the interests of the insurance buying public, brokers can contribute substantially as both business and government grapple with expanding notions of liability and the inevitable rise in insurance costs.

For instance, in a six-week period earlier this year, San Francisco Bay area juries granted three punitive damage awards totaling nearly $200 million. Such awards testify to the fact that our judicial system seems to be changing from a compensatory system to a punitive windfall system.

As excessive as judicial judgments frequently seem, such awards reflect attitudes which are deeply imbedded in contemporary American culture. Americans increasingly use litigation to resolve disputes, particularly when the plaintiff has no personal or communal ties to those being sued. In this environment, it is understandable that plaintiffs seek accountability, retribution and financial gain through the courts.

In a recent Ohio Supreme Court case, Oswald vs. Connor, the court ruled that a surviving spouse can collect workers' compensation death benefits when an occupational disease is found to have substantially affected a worker's health.

In this case, a zoo employee, who died in 1976 at the age of 54, had among other illnesses — avian tuberculosis. However, he was also affected with the pre-existing conditions of coronary disease, hypertension, diabetes and the effects of heavy smoking. This example clearly illustrates our society's expanded vision of civil liability.

In this environment, the analytical skills and business expertise of brokers are uniquely suited to address the escalating crisis in our civil justice system — a crisis which is driving consumer costs higher and higher. It is increasingly obvious that few citizens ultimately benefit from the skyrocketing cost of litigation and awards.

In the months ahead, American brokers will be seeking to clarify their role for both the business public and Washington policy makers. The consumer services brokers provide have been frequently obscured by negative stereotypes associated with certain excesses in the insurance industry.

Until recently, there was a pervasive feeling among brokers that we would be well served to continue our work in relative obscurity. In light of general business and insurance trends, it is obvious that the time has come for visibility and broad public understanding of brokers' special role in the U.S. and world economy. ■

THE BROKERS' ROLE

By Robert H. Moore
Alexander & Alexander Services, Inc.
President, National Association of Insurance Brokers

From an address at the NAIB Annual Meeting

In a six-week period earlier this year, San Francisco Bay area juries granted three punitive damage awards totalling nearly $200 million. Such awards testify to the fact that our tort system of recovery is changing from a compensatory system to a punitive windfall system.

But should we really be surprised by such decisions? When multi-millionaire athletes and rock stars typically make tens of thousands of dollars for one game or one performance, is it really that surprising when the courts award average American citizens hundreds of thousands of dollars for injuries or for occupationally-related, life-threatening illnesses? Or, to ask a related question – what price does one put on environmental impairment which affects families and neighborhoods?

As excessive as many of these judicial judgments may seem, and as potentially ruinous as they may be for our industry, we must deal with the fact that such awards reflect attitudes which are deeply imbedded in contemporary American culture. Whether we like it or not, we are living in an increasingly mobile society characterized by a diminishing sense of community. Ours is a society that increasingly uses litigation to resolve disputes, particularly when the plaintiff has no personal or communal ties to those being sued. In this environment, it is quite understandable that plaintiffs seek accountability, retribution and financial gain through the courts.

Those who still believe that extraordinary court decisions are primarily coming from bastions of liberalism such as San Francisco may be interested in the Ohio Supreme Court's recent ruling in the *Oswald vs. Connor* case. The court ruled that a surviving spouse can collect workers' compensation death benefits when an occupational disease is found to have substantially affected the worker's death. This particular worker, who died in 1976 at the age of 54, had – among other illnesses – avian tuberculosis – apparently as a result of having worked with animals at a zoo. However, he was also affected with the preexisting conditions of coronary disease, hypertension, diabetes and the effects of heavy smoking.

Unprecedented Effort

The San Francisco rulings and this Ohio Supreme Court case are only two examples in a long litany of instances which demonstrate that our industry is faced with problems far more serious than excesses in our legal systems, or poor underwriting practices. We are confronted by social, political and cultural trends which can not be turned around in the short term. In fact, to properly address these trends will require an unprecedented effort on the part of our industry in concert with our clients and sympathetic parties in government and the legal profession.

In light of these trends, what is the NAIB's role over the next several years?

A primary objective will be to clarify the broker's role for Washington legislators and regulators. We will also work to see that those in the public policy community and the media better understand what brokers do.

Washington policymakers and the business press tend to see the insurance industry as a monolithic force. Our industry is frequently viewed as a mystifying enterprise, manipulating vast assets for its own ends and hiding behind actuarial tables and mountains of statistics. This is a "bad rap" for the industry. The valuable services brokers provide are totally obscured by such negative stereotypes.

Our function as problem-solvers, representing the interests of the insurance-buying public, is not widely understood. We have enormous potential leverage as consumer representatives, but this potential will not be realized if our profession has a low profile in Washington or in the media. As brokers, we have a lot to gain individually, and our industry also would be well served, if we create more effective opportunities for bringing our professional perspective to bear on major business and industry issues.

Our first goal then is to make sure that legislators, regulators and others who influence public policy understand what we do.

A Heightened Image

Our second objective, closely related to the first, is to heighten our professional image and reputation.

Until recently, there was pervasive feeling among brokers that we would be well served to work in relative obscurity insofar as the federal government or the national media was concerned. In light of general business and insurance trends, it is obvious that the time has come for visibility and broad public understanding of our special role in the U.S. and world economy.

Once policymakers and the media better understand our role, we will face the added burden of enhancing our image and professional reputation. We must develop strategies for bringing our expertise and knowledge to bear on public policy issues. We must more effectively communicate how we work with the commercial, as well as the not-for-profit insurance buyer, to meet their risk management needs.

Our ingenuity and creativity, our experience and expertise, should be central themes in NAIB communications. An abundance of these qualities in our profession, combined with our vested interest in helping the insurance-buying public solve its problems, puts us in a unique position to be useful to policymakers.

How will we accomplish our objectives?

Like most things, there are few real secrets and even fewer useful shortcuts. The only way to accomplish our objectives is with planning, organization and hard work.

Three Basic Elements

Our action plan has three basic elements.

First, at the executive committee and board committee level, we will take a vigorous hands-on approach to working with the NAIB staff.

Secondly, we will strengthen our association as an information resource for its members.

Thirdly, we will begin the process of "positioning" the NAIB in certain key areas.

Our Washington office is well established. Under the management of David Lambert, we have an experienced staff in place. Barbara Haugen and Lee Backus are professionals who understand the broking business. Our political action committee, NAIBPAC, has been through one election cycle and achieved an impressive record of backing 35 winners in 38 contests.

To build on these achievements, I will work closely with Ray Hayes, our newly-elected First Vice President, to achieve maximum continuity in NAIB strategy and action plans. I intend to have daily contact with NAIB staff. We have established a schedule for weekly sessions to evaluate and refine the Association's strategies and activities.

With the Executive Committee's endorsement, a number of new committee and subcommittee chairpeople are in place for 1985-86. Particularly noteworthy is the Laws and Legislation Committee, chaired by Ham Loeb, who will be joined by a number of new subcommittee heads.

A second goal of our 1985-86 action plan is to strengthen the NAIB as an information resource for our members. We will, for example, expand the distribution of selected material from our "Legislative Updates." In the past, updates have gone only to board members as part of their quarterly board book. In the future, we will also distribute excerpts of this material to those within the brokerage community who receive the ***Friday Flash***.

As substantive policy analysis is generated by our committees, we will share our findings with member firms on a timely basis. We will also make aggressive use of the NAIB's special bulletins to respond to legislative or regulatory developments.

Our third goal involves positioning the NAIB as a major participant in resolving insurance industry issues. Our concept of this process is uniquely suited to the broker's problem-solving skills. We want to be an expert resource to legislators in developing policy, rather than simply a partisan advocate of a specific policy.

The NAIB's role will be a blend of political savvy, the broker's entrepreneurial sales skills and the genuine expertise of our profession. Our NAIBPAC contributions, combined with constituent as well as personal relationships with key congressional members, are essential aspects of this approach.

As you know, we developed NAIBPAC not simply to support friends of the insurance industry but also as a way of expressing support for members of Congress who are, or who may become, leaders in the legislative and policymaking process. Rather than simply lobbying on narrow issues of special interest to brokers or to our industry, we have also used, and will continue to use, NAIBPAC to acquaint members of Congress with the broking business.

We must demonstrate the brokers' analytical skills and business expertise to members of the House and Senate, as well as to regulators and members of the executive branch. For the NAIB's efforts to be successful, the burden rests on this board, and on our committees, to identify and work with individuals within our firms who can come to Washington as a resource for policymakers. We can assist policymakers in grappling with such immediate issues as environmental impairment liability and the larger questions of the availability and affordability of various coverages.

Additionally, there are issues on the horizon such as insurance company insolvencies and the possibility of a national crisis if major insolvencies occur. There are other subjects too, not centered in our industry, but offering the opportunity for a constructive and useful contribution. One example is the escalating crisis in our civil justice system as the cost of litigation and awards to plaintiffs continue to skyrocket. This poses a serious dilemma for the country at large, and brokers can bring a helpful perspective to this dilemma.

None of these issues is amenable to quick or simple solutions – but this should not deter us from making intelligent contributions to resolving them. Who in the insurance industry is better suited to the task than brokers?

Positioning the NAIB as a credible and helpful resource to lawmakers is an *achievable* objective. It will take planning, organization and hard work, but the payoff will be long lasting.

If the NAIB does not expand its reach to respond to major policy issues that are being analyzed and debated in the insurance industry, we have forfeited any right to influence the outcome. To the degree that attempts to resolve these issues are ill-informed or arbitrary – to the degree there is unfair or inept federal, state or judicial intervention – we will not only have failed our clients, we may have also put our own livelihood at risk.

There is no reason to let our professional and personal destinies slip into the hands of others. We can be the captains of our own fate – *if* we are prepared to take on the challenges of our time. And we have in the U.S. broking community men and women who are more than equal to the challenges we face.

I am honored to be part of our profession. ☐

NAIB Withdraws CGL Opposition

By JAMES NOLAN

Journal of Commerce Staff

NEW YORK — Major insurance brokers have lent lukewarm support to a new commercial liability policy.

The National Association of Insurance Brokers said it will no longer lobby with state regulators, urging them to reject the property/casualty industry's new "claims-made" policy form.

But at the same time, the NAIB withheld endorsement from the Commercial General Liability policy that has been drafted by the Insurance Services Office, an industry sponsored rating and research body.

The NAIB said that "the needs of our clients are better served by modifying NAIB's active opposition to the CGL program implementation."

Robert H. Moore, NAIB president and senior vice president of Alexander & Alexander, the nation's second largest insurance broker, said that the next important step was up to the ISO.

"This decision," Mr. Moore said, "does not imply approval of the forms, nor agreement that they provide full protection to the insurance consumer. We urge ISO to encourage underwriters to meet the availability needs of insurance consumers as aggressively as it marketed the claims-made form."

At the ISO, a spokesman said the group was gratified with the NAIB statement.

Asked how the ISO would respond to Mr. Moore's request for an aggressive marketing plan to make more insurance available, an ISO spokesman said:

"The very business of an underwriter is to meet the needs of customers. ISO's role is to make available tools to help the underwriter do the job. The claims-made form is a step toward helping the underwriter do this."

Further qualifying its support, the NAIB said that "the new forms provide less financial protection than the existing occurrence form they replace. Clients may find that they must self-insure losses that the existing occurrence form would have covered.

"Today, the unavailability of liability insurance is having serious adverse effects on our clients. Frequently, coverage is not available at any price. ISO and the underwriting community have indicated that adoption of the new CGL program will substantially increase the availability of liability insurance."

'The needs of our clients are better served by modifying NAIB's active opposition to the CGL program implementation.'

The scarcity of liability insurance was the concern also this week of a second major producer organization, the National Association of Professional Insurance Agents.

The PIA denounced underwriting companies in an advertisement in a national insurance weekly for canceling liability insurance before a policy has expired.

James H. Davies, PIA president said in "a message to agency companies" that the "unfair practice of midterm cancellations often places commercial clients and agents in difficult situations, forcing them to scramble to find coverage during already tight market conditions."

Mr. Davies speculated that "if midterm cancellations continue" state legislators will clamp down hard on underwriters with restrictions that "will remain long after temporary market problems subside."

PIA officials in New York and New Jersey were unable to say which companies Mr. Davies was addressing when he said that "if your company is engaging in this practice, we ask you to reconsider your action and its long-term consequences."

And from another quarter, the Independent Insurance Agents of America worried that the shortage of liability insurance would drive corporations to seek alternatives that would fall outside of regulation by the states.

Richard G. Taylor, IIAA president, warned that corporations that get their insurance from such non-regulated markets would be "extremely vulnerable because they would not be protected by state guaranty funds."

Mr. Taylor told an executive meeting of the National Association of Insurance Commissioners that "the states in which there are healthy jurisdictions are those in which insurers will begin to write the more difficult lines of business once again."

He thus added his voice to the growing clamor in the industry for reforms in state tort law governing liability suits for personal injury.

Thursday, February 13, 1986

The Journal of Commerce
AND COMMERCIAL
A Knight-Ridder Newspaper

Senator **Bumpers**. Thank you, Mr. Temp.

Mr. Temp, let me just say that the suggestions you make here to be fairly sensible. Certainly, Congress ought to be willing to provide some tax relief to people who necessarily must become self-insured, and I certainly have no objection to looking at our tort system to see what the impact is.

And finally, I think it's appropriate—if there's any way to do it at the national level—as has been pointed out here, we traditionally leave all this to the States. But it seems to me that it would be appropriate to find out whether the insurance companies are addressing the problem as it exists, or as they anticipate it, and to what extent these premiums, almost without exception—and, you know, we're just dealing here with principally small businesses; Betty and I help take care of an 88-year-old woman in the State of Arkansas whose only asset is her home. And the insurance premium on her home—as far as I know, she's never filed a claim in her life—is going out of sight. The elderly—that's a whole another thing.

But it isn't just small business; everybody's getting it. And as has been said here, finger-pointing isn't going to solve the problem. What we need, really, are these hearings from all segments: the lawyers, the insurance companies, and the businesses—we are principally interested in small business here—to find out whether or not the rates are justified. And if they are justified, figure out how we can resolve it.

Have either one of you testified before any State legislative committees as to this problem?

Mr. **Temp**. No, I have not, except——

Senator **Bumpers**. Have you, Mr. Young?

Mr. **Young**. No, I have not.

Senator **Bumpers**. I assume that the legislatures that are in session this year are going to be considering redressing the problem because if their mail is running like mine is, it's a critical problem for everybody.

Mr. **Young**. They really aren't.

Mr. **Temp**. If I may, sir, the commissioner of the State of Wisconsin, Thomas Fox, has formed a task force and they have set up three subcommittees. And they're addressing industry conduct, No. 1; No. 2, market assistance plans and pools; and lastly, the civil justice reform. And I commend their commissioner for doing that. I think that's a great step.

Senator **Bumpers**. One point you make here about a lawsuit being filed on a piece of equipment that is 40 years old. That is obviously outrageous.

Mr. **Temp**. Yes. And a number of examples we've cited in the previous testimony, too, of equipment that was much older than that, and sold many more times than three times.

Senator **Bumpers**. As I say—you know, I'm not suggesting that our tort laws are perfect, because they certainly aren't. And maybe some tinkering or adjusting is in order. I'm always just reluctant for the big, old Federal Government to start overseeing another form of people's lives.

You know, it's an interesting thing. Everybody believes in States' rights when it's to their benefit, and they don't believe in it when it isn't to their benefit. It's a philosophy that you can go either way on.

You know, there's a proposal up here to amend the Hobbs Act to get the FBI and the Federal Government involved in picket line violence. And there again, that's just another place, you know, where they're coming with the Government. It's a violation of State law already, and what you're doing is, you're just adding another layer to enforce the law; both the State and the Federal Government in the future would be involved in picket line violence because violence is a crime in every State in the United States. And I'm troubled by that. I don't know how I'm going to vote on it when it comes up. Apparently, I'm going to get to find out before long.

But I just—you know, I think one of the most conservative positions anybody can take is to say that the Federal Government ought not to be moving into this area. We've moved into so many areas; and yet, this is a problem so critical that maybe there is a role for the Congress to play here in regulating it. There may be an antitrust role. We've pretty much taken hands off of the antitrust field where insurance companies are concerned, and maybe there's a role for us to limit liability. I don't know.

At the end of these hearings, we will probably be considering some legislation.

Thank you both very much for appearing this morning.

Mr. TEMP. Thank you.

Mr. YOUNG. Thank you, Mr. Chairman.

Senator BUMPERS. Our last two witnesses—and they are supposed to testify separately, but if they don't mind sitting beside each other while each testifies, I'll ask both of them to come forward—are Mr. Steve Martin, vice president of Government relations, the Hartford Co.; and Robert Habush, an attorney from Milwaukee, representing the American Trial Lawyers Association.

Mr. Martin, I went up to take a deposition one time when I was practicing law, in Hartford; and when I got back home, we had a State senator in Arkansas who was considered to be a little bit of an ambulance chaser and filed suit against insurance companies constantly. And they said the reason was because he went up to Hartford one time and saw all those big old high rise buildings owned by the insurance companies, and so he just took them on the rest of his life. He decided it would be easy pickin's.

Mr. Martin, why don't you proceed first?

STATEMENT OF STEVE MARTIN, VICE PRESIDENT FOR GOVERNMENT RELATIONS, THE HARTFORD INSURANCE GROUP, HARTFORD CT; REPRESENTING THE AMERICAN INSURANCE ASSOCIATION

Mr. MARTIN. If I might, before I start, in response, a lot of those buildings were paid for by life company money.

Senator BUMPERS. I understand.

Let me suggest to both of you, also, if you don't mind—your whole statement will be entered in the record. If you can summarize, I will be grateful to you.

Mr. MARTIN. I have a brief overview I'd like to present.

I'm Steve Martin of the Hartford Insurance Group. I'm appearing today for the American Insurance Association.

Liability insurance problems faced by small business today appear to be twofold. Their insurance premiums have increased substantially in the past year, and insurance for certain risks has become unavailable. Increased premiums have occurred following a 5-year period beginning in 1980 of the most intensive competition for business which the insurance industry has ever seen. Driven by the expectation of high returns on investment of new money, many insurers, excess insurers, and reinsurers began to underprice their products, and others were soon forced to follow suit. Those who tried to buck the tide quickly lost business.

In the meantime, the public benefited enormously from premiums each year that, for many, were lower than each prior year. All along, losses were being incurred for which premiums plus investment income were supposed to cover.

More and more, with each passing year, they did not. In 1984, the property and casualty insurance business experienced the worst underwriting and operating results in its history. Its pre-tax operating income—a combination of investment income and underwriting results—was a negative $3.8 billion. And the cycle began to change.

Insurers, excess insurers, and reinsurers have taken a financial beating from which some would not recover, and from which others would recover slowly. Companies began repricing and reunderwriting their business, and this meant price increases and minimizing the riskiest businesses. And some who were having serious financial problems or who lost or faced reduced reinsurance dropped some of the classes of business they had been writing.

Unanticipated upward pricing by insurers created budget problems for small businesses and others, such as municipalities and professionals. Withdrawal from the market for specialty classes of risk by insurers who generally wrote a lot of that particular class created acute availability problems. In many States, availability problems such as these are being addressed by voluntary insurance industry-supported market assistance programs, 34 States so far. These maps generally encompass liability insurance for day care centers, liquor liability, and municipalities; but many are prepared to address other problems where necessary.

Notwithstanding individual insurer pricing actions during 1985, that year was also very costly for the industry. At 9 months, the industry's operating loss exceeded $3.5 billion. But individual loss ratios by line of business began to moderate as earlier pricing began to take effect. Price levels are still below that necessary to generate sufficient income to pay for losses which are expected from current and future business. Nevertheless, we detect a revival in the marketplace. A major insurer has come out with a new day care program; some new liquor liability markets seem to be developing; special programs are being marketed for municipalities.

Many insurers, excess insurers, reinsurers, and analysts have expressed serious concern about the increased unpredictability of commercial liability losses. It is the volatility of those exposures which affects underwriting judgments with regard to current pricing and reunderwriting. Predictability is a function, we submit, of the tort system; and the tort system is full of unpredictables with regard to insurance and business exposures. Courts make new rules of liability all the time. Damages are virtually unlimited. Punitive damages can be awarded regardless of a person's exercise of due care. A slightly negligent codefendant can be held 100 percent liable for an award, if the other codefendants or responsible parties are without funds. Insurance contracts are interpreted beyond their clear intent. Existing limitations on causes of action are eroded and new elements of damage are continually being created.

All of these changes are courtmade and generally have escaped any formal legislative oversight function. All these courtmade doctrines continue to affect the cost to all of us of the liability system. You cannot create more causes of action, encourage more litigation, impose ever-broadening deep pocket doctrines, and foster the notion that every injury, however caused, is entitled to recovery from someone with full tort and punitive damages without generating more costly claims and lawsuits, more loss handling expenses, and more settlement costs and judgments which have to be paid. All of this is beginning to take its toll on our society.

Obstetricians are giving up or cutting back. Vaccine manufacturers are shying away from medically useful vaccines. Some pharmaceuticals are not being made available, even to people who need them. Engineers and architects are being warned away from projects likely to generate lawsuits.

Businesses, municipalities, and professions, many of whom have their own insurance mechanisms, recognize the unfairness of the deep pocket extremes to which the courts are going, and are banding together with insurers and others in State after State, in efforts to address these problems effectively and fairly.

It is our view that the worst of any insurance crisis will soon be behind us, and that the constructive efforts by State regulators to mitigate conditions leading to such crises—and that State-by-State changes in the tort system—are all essential steps toward improving the availability and affordability of insurance.

Thank you.

[The prepared statement of Mr. Martin follows:]

STATEMENT OF THE AMERICAN INSURANCE ASSOCIATION

BEFORE THE SENATE SMALL BUSINESS COMMITTEE

CONCERNING

THE COST AND AVAILABILITY OF LIABILITY INSURANCE

FEBRUARY 20, 1986

American
Insurance
Association

The American Insurance Association is a national
trade organization of casualty insurers.

PROFILE

The American Insurance Association is a full-service trade organization of casualty insurance companies. In its present form, the association combines three earlier organizations. One of those, the former National Board of Fire Underwriters, was organized in 1866, making it one of the oldest trade associations in the nation.

The various departments provide members with up-to-date intelligence on legislative, regulatory, judicial and technical developments relating to our industry. The AIA also maintains liaison with insurance regulators, federal and state lawmakers, other state and federal government officials, insurance and non-insurance industry groups and media—supplying information and assistance on issues of mutual concern.

A countrywide system of regional offices and local legislative counsel ensures prompt and rigorous attention to casualty insurance matters. At the same time, technical specialists from disciplines as diverse as law, economics and engineering educate members and outside publics on developments that may affect the industry and its services to the insurance-buying public.

The American Insurance Association (AIA) is a trade association which represents 170 property and casualty insurance companies. The member companies of the Association provide the majority of the commercial liability insurance coverage written throughout the United States. We have been asked to present testimony associated with the scope of the availability and affordability of liability insurance problem currently being experienced by the purchasers of insurance.

Insurers are exhibiting neither panic nor irresponsibility by taking a conservative stance on writing certain lines of commercial liability coverage. Rather, they are being prudent in the face of unprecedented losses and a rapidly changing operating environment.

UNDERLYING CAUSES

The "insurance industry" is not monolithic. Even the largest companies have a small portion of the total market share in any single line of insurance. Individual insurers engaged in intense competition in the early 1980's in pursuit of the premium dollar in order to invest. Insurers were able to reduce the price of their product by balancing underwriting losses with investment income until 1984. Lower prices inure to the benefit of the policyholder.

Extraordinary losses experienced by insurers, particularly in commercial casualty lines, have forced insurers to raise premiums dramatically. These premium increases have clashed with the expectations of policyholders, causing hardship among some policyholder groups who rely on various lines of commercial liability coverage.

Many insurers have experienced such financial hardship that they have withdrawn from writing some of the lines of insurance they formerly wrote.

This is clearly the case insofar as specialty lines, such as day care centers, dram shop liquor liability, and, to some extent, municipalities are concerned. However, withdrawal from these lines of insurance is, in many instances, also generated by the reinsurance market, which itself has sustained massive financial losses from its U.S. operations.

Insurers and reinsurers are recognizing that pricing and underwriting expectations for many classes of commercial liability insurance have been rendered unreliable because of the unpredictability of future losses. Judicial misinterpretations of insurance contracts, statutory and common law modifications of the tort system, mandated minimum levels of insurance in federal* and state laws, society's increasing expectation of recovering higher and higher amounts from some "deep pocket" for virtually every injury, have taken their toll on the predictability of losses.* These developments affect virtually all forms of commercial liability insurance, but they especially affect long-tail exposures where the insurer's (and reinsurers') policies can be invoked five, ten, or even twenty years after the policy was written.

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* Bus Regulatory Reform Act, Motor Carrier Act, Superfund, and the Resource Conservation and Recovery Act.

* -- Ayers v. Jackson Township (N.J., 1983) -- $15.6 million settlement for alleged waste site injuries.

-- Dietz v. Gray Brothers (Pa., 1984) -- $750,000 judgment for alleged waste site injuries.

-- In Re Agent Orange (N.Y., 1984) -- $180 million settlement for alleged defoliant injuries.

-- U.S. v. Olin (Ala., 1983) -- $24 million settlement for alleged DDT disposal site injuries.

-- Piatt v. Independent Petrochemical (Mo., 1983) -- $2.6 million judgment for alleged dioxin injuries.

-- LaPoint v. Hooker Chemical (N.Y., 1984) -- $20 million settlement for alleged Love Canal waste site injuries.

The most basic concept underlying insurability and insurance contracts is the concept of risk. "Risk" means literally the "chance of loss" or the "probability of loss." If a loss is certain to happen, then there is no risk of loss to transfer, and an insurance transaction cannot take place. There is a growing perception among underwriters that the accumulation of legal remedies provided under state and federal liability systems are changing a hitherto insurable probability of loss to an uninsurable, virtual certainty. Underwriters are attracted to predictability of loss but must avoid inevitability of loss.

The second basic fundamental of underwriting and insurability is that of predictability. If there is no way to forecast the timing or amount of a loss from past experience, then the loss is unpredictable. Any estimate would be pure speculation.

Standard coverage for liability insurance originally applied to bodily injury or property damage "caused by accident". The accident concept was also the time trigger of coverage and the building block of limits of liability. An individual policy covered only accidents which occurred during the policy period.

The classical accident, as perceived by insurance underwriters and policy drafters, was concrete, rather than abstract. They regarded an "accident" as a sudden event of a physical nature that happened by chance at a definite time and place and caused rather obvious injury or damage - a collision of vehicles, a scaffold which broke, a roof which collapsed. "Accident" was not a legalistic concept. The underwriters' conception of "accident" harmonized well with both the classical liability principles of tort law and the fundamentals of insurability. Certainty as to time and place laid the foundation for reasonable predictability.

By 1970, it became apparent that coverage based solely on the classical accident concept was no longer adequate for most insureds. There were true "risks of loss" that did not arise out of sudden causes, but were the result of continuous or repeated exposure to physical causes which resulted in nontraumatic, multiple causation, long-latency diseases.

The extent of exposure for liability insurance coverages has changed dramatically in the past decade. The relationship between low level exposures to useful, but sometimes harmful substances, and injuries to human beings is not well understood today and is still to a large extent speculative. Tort law a few years ago did not concern itself with speculative possibilities of harm. Doctrines of joint and several enterprise liability had not been formulated. It was not until 1974 that the deluge of asbestos-related claims began.

The concept of accident as a single scenario involving one person causing another's harm has changed. Increasingly, recent tort law has applied traditional concepts of individual risk-placing causation and harm into the modern commercial context. The result is that certain communities, types of persons throughout the nation, or classes exposed to risk of harm through commercial enterprises have sought to redress their harm through the liability system and have sought to hold entire industries liable for the creation of public risks. New types of suits differ from traditional cases in that:

- Injuries are medically complex and have multiple causes, often resulting in the introduction of presumptions into the legal system,

- Injuries have been attributed to exposure over a lengthy period of time,

- Injuries have been applied to groups or classes of claimants,

- Defendants are often a small number of entities or businesses or whole industries involved in certain types of behavior.

The Deep Pockets Report, prepared by the Institute of Civil Justice in 1985, indicates awards differ among types of defendants. Awards against corporate defendants averaged over $120,000 as against awards for individual defendants of $18,500. Where injuries were the same, corporate defendants paid 30 percent more than individual defendants. Notably, governmental defendants, which 20 years ago were protected by the Doctrine of Sovereign Immunity, where subjected to an average award of $38,000.

Certain classes of additional defendants are perceived differently than in the past. The problem of drunk drivers causing an innocent third party's injury has resulted in the expansion of liability to include the provider of the alcohol. In the past, everyone understood that some risk was inherent in any vaccine. However, in recent times, law suits have proliferated against vaccine manufacturers.

Recent court decisions have created new and unpredictable liabilities for property/casualty insurers. As stated in the Villanova Law Review:

- In two recent toxic tort cases, the highest courts of California and New York have held that liability for injuries allegedly caused by DES can be imposed upon defendant-manufacturers without proof that those defendants made DES which caused the plaintiffs' injury. In Sindell v. Abbott Laboratories (1980), the California Supreme Court accomplished this result by fashioning a "market share" theory of liability. Under this theory each defendant was liable for the proportion of the judgment represented by its share of the DES market unless the defendant could demonstrate that it could not have made the product which injured the plaintiff.

Subsequently, in Bichler v. Eli Lilly & Co. (1982), the New York Court of Appeals affirmed a jury verdict against a manufacturer of DES which was based upon the plaintiff's theory that Lilly, in concert with other DES manufacturers, had wrongfully marketed this drug without proper testing. Under this "concert of action" theory, the court in Bichler found the defendant liable for the plaintiff's injuries even though the plaintiff had failed to prove that Lilly--the only defendant named in the suit--was the manufacturer of the DES that the plaintiff's mother had ingested.[1]

In both Sindell and Bichler, the rationale underlying the courts' decisions was the same. In both cases, the court was confronted with an innocent victim unable to prove which manufacturer harmed her because of the long latency of the injury coupled with the similarity among the products of the different manufacturers. Faced with a choice between not compensating the victim and holding liable a company which may not have caused the harm, each court chose a theory which would permit compensation of the victim.

Other judicial decisions have weakened defenses based upon the state of the art and technological or economic feasibility. In Beshada v. Johns-Mansville Products Corp. (1982), a manufacturer of asbestos in the 1930's was found to have an obligation to warn of the dangers associated with asbestos products. The manufacturer was not permitted to prove that at the time in question it was not possible to determine the possible harmful affects of asbestos. Prior to this decision, under the state of the art defense, even in strict liability cases, no manufacturer would be held liable for harm caused by conduct or products that could not have been anticipated under state of the art knowledge. This novel decision is a particularly significant finding for chemical product manufacturers because they may be held liable even in instances in which the harmful potential of the product was not discoverable at the time.

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[1] Villanova Law Review, Volume 28, No. 6, September, 1983, p. 1102-1104.

Rulings of this type dispense with a fundamental element of the tort system--proof that the defendant was responsible for the plaintiff's harm. Such rulings disrupt the reasonable expectations of both manufacturers and insurers concerning the limits of their liability.

Judicial misinterpretations of insurance policies designed to respond to limited types of pollution exposures have created additional concerns among insurers. Recent court decisions have expanded insurance coverage for cleanup of waste treatment, storage and disposal facilities beyond that which the liability policies were designed to provide. Insurers have lost confidence in the words and phrases of art which have been placed in pollution insurance contracts in order to exclude coverages which may be provided in other insurance policies or which may be properly excluded due to the unpredictable or potentially catastrophic nature of the exposures.

The Comprehensive General Liability (CGL) insurance policy is the instrument used to provide the vast majority of insurance protection for commercial entities from liability for bodily injury and property damage. The CGL insurance policy is a contract between the insurer and the insured in which the parties define both the risks covered by the insurance and those excluded from coverages. The premium charged by the insurance company relates directly to the frequency and severity of the risk that the company intends to insure. Courts have elected to misinterpret the insurance policy contract language in order to maximize insurance coverage for damages related to hazardous waste.

Some decisions have gone so far as to rewrite policy terms and create coverage which insurers never intended to provide and for which no premium was ever collected. Specifically, we perceive a trend in court decisions that interpret our standard CGL policy to broaden the scope of intended coverage as follows:

- Narrowing the intent of the owned property exclusion to find liability for damage to an insured's property.[2]
- Overriding the scope of the pollution exclusion so that, for example, well contamination caused by seepage at a hazardous waste site that occurred over a 12 year period was found to be covered despite the policy requirement that coverage be afforded for only "sudden and accidental" pollution.[3]
- Converting the CGL's policy dollar limit per occurrence into a per claim dollar limit.[4]
- Setting aside the definitions of property damage and bodily injury so as to award speculative damages for the possibility of future harm.[5]

The possibility of similar misinterpretations leading to expansion of coverage in the commercial auto policy exists due to the inclusion of the category of damages for "environmental restoration" in the Motor Carrier Act. Many commercial auto insurers have reacted by excluding environmental restoration from their commercial auto policies.

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[2] See for example, Riehl v. Travelers Insurance Co., ___ F. Suppl. ___, Civil Action No. 83-0085 (W.D. Pa., August 13, 1984).

[3] See, for example, Jackson Township Municipal Utilities Authority v. Hartford Accident and Indemnity Company, 186 N.J. Super. 156, 451 A.2D 990 (1982). Waste Management of Carolinas, Inc. v. Peerless Insurance Company, 323 S.E. 2D 726 (Court of Appeals of North Carolina, December 28, 1984).

[4] See Township of Jackson v. American Home et. al., Docket No. L-29236-8 (Law Div., August 31, 1984).

[5] Ayers et. al. v. Township of Jackson, 189 N.J. Super. 561 (Ocean County, April 5, 1983).

Concurrent with judicial misinterpretations of insurance contracts, rapidly expanding liability concepts, and the recent drain on insurance industry surplus, the Congress has created a series of expanded responsibilities for insurers and their policyholders by mandating evidence of financial responsibility in a series of recently enacted federal legislation. The Motor Carrier Act (1980) and the Bus Regulatory Reform Act (1982) have mandated large minimum insurance requirements for buses and trucks. In the case of a motor carrier transporting extra-hazardous substances or a bus with a seating capacity in excess of fifteen, the minimum requirement for insurance is $5 million per vehicle. Although the Resource Conservation Recovery Act was enacted in 1976, the final rule associated with the financial responsibility requirements for waste, treatment and storage facilities was promulgated in 1980. Those financial responsibility requirements have been phased-in over the last 5 years. An additional wave of financial responsibility requirements can be anticipated in association with the Comprehensive Environmental Response, Compensation, and Liability Act of 1980. All of these requirements for evidence of financial responsibility have coincided with the insurance industry's underwriting losses beginning in 1979.

INSURER OPERATING RESULTS

In order to put the present liability insurance problems in perspective, it is necessary to understand the overall financial condition of the insurance industry today. Since 1980, losses and expenses have exceeded premiums primarily because prices failed to keep pace with loss costs. As a result, an unbroken string of underwriting losses began in 1979 and grew at an average annual rate of $3 billion through 1983. An even more dramatic increase took place in 1984 when underwriting losses jumped $8 billion, reaching $21.3

billion. Losses from underwriting for the six years 1979 through 1984 totalled $55 billion. With investment income falling far behind underwriting losses, the industry's pre-tax operating income - the combination of investment income and underwriting results - plunged to a negative $3.8 billion in 1984. Operating losses for the first nine months of 1985 have exceeded $3.5 billion.

The commercial liability lines experience has been particularly negative. Four key commercial lines - general liability, commercial multi-peril, workers' compensation and commercial automobile - have suffered enormous underwriting losses. General liability leads all lines of insurance with the highest combined ratio of 152.

As a business, the industry cannot afford to indefinitely price its product at less than cost. As stated by the Insurance Services Office:[6]

> The decline in surplus and questions as to adequate loss reserves have raised concerns about the solvency of many insurers. In 1984, at least 22 property/casualty insurance companies were found to be financially impaired. Most of these companies were insolvent. Additionally, several sizable insurers were placed in rehabilitation by regulators with an indication given that liquidation could not be avoided. In total for 1984, companies accounting for more than one fifth of industry premiums failed 4 or more IRIS tests. As of mid-November 1985, 38 companies have become insolvent since the beginning of 1984. That is more insolvencies than in any full two-year period since guaranty funds were formed, and the books aren't yet closed for 1985.
>
> A.M. Best Company annually conducts a specialized financial analysis of most United States insurance companies and expresses its evaluation in the form of a rating. All companies rated "Excellent" are considered to be outstanding and have no material unfavorable variances from A.M. Best's averages. Lower ratings reflect increasingly unfavorable variances from A.M. Best's industry standards. An "Excellent" rating is considered essential if an

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[6] Financial Condition Of The Insurance Industry-An Update

insurer wishes to do business with top U.S. corporations, municipalities and government contractors.

From 1982 to 1983, 30 companies' ratings were upgraded to "Excellent" while 78 companies' ratings were downgraded from "Excellent". In 1984, there were 38 increases to "Excellent", but 150 companies received rating decreases from this level. When the 1985 ratings were issued, 25 companies had an increase in their rating while 331 companies saw their rating drop.

The declining solidity of the property/casualty industry is also illustrated by what is termed the exposure ratio, defined as the ratio of net written premiums to surplus. The percent of industry premiums written by companies with high exposure ratios has increased dramatically. The National Association of Insurance Commissioners (NAIC) has selected a premium-to-surplus ratio of 3-to-1 as a maximum. Any insurer writing above this level fails the premium-to-surplus test. While only 4 percent of the industry's premium was written by companies with a premium-to-surplus ratio above 3-to-1 in 1982, by 1984 that increased to 15 percent and estimates are that it will exceed 20 percent by the end of 1985.

While the financial results of the property and casualty insurance industry are partly the result of a competitive pricing cycle, the industry has also come to recognize that it has become a victim of fundamental changes in the civil justice system during the past decade. More and more, insurers have encountered court interpretations of prior insurance contracts which expand coverage beyond that which insurers intended. As a result, the availability and cost of insurance for current liability is significantly influenced by: insurers' concern about potential unanticipated past liability, the magnitude of potential liability, both past and future; the seeming inability to use contract language to prudently limit insurers' exposure; and a civil justice system that continues to create new theories of liability and to expand older theories.

VOLUNTARY SOLUTIONS

The American Insurance Association has thus far categorized pollution liability and asbestos abatement contractors' liability as falling into the unmanageable or uninsurable category. In addition, there are a number of availability problems in lines that are badly damaged by the liability system, but there is still a potential that insurers can provide coverage.* In these areas AIA will work actively with its companies, other trade associations and state insurance commissioners to explore voluntary Market Assistance Programs or other market solutions to the problem. A Market Assistance Program (MAP) establishes a central administrative point where a buyer who is experiencing difficulty in purchasing insurance may come in order to be referred to one or more participating insurers who employ their established underwriting criteria and rating plans. A MAP can also serve to gather information about real or perceived availability problems and be a focal point around which the insurance department, buyers' groups, agents and brokers may discuss availability problems in a constructive manner.

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* Day Care Centers, Liquor Liability, Directors and Officers, Physicians Malpractice Insurance, Nurse Midwives, Commercial Auto Insurance (Long Haul Trucking Companies and Bus Companies), Rural Homeowners Insurance.

It should be emphasized that merely shifting the burden from one insurance mechanism to another does not address the key problem associated with availability/affordability of liability insurance. Artificial, involuntary insurance mechanisms such as Joint Underwriting Associations mask the underlying problem. The answer to this dilemma has been and remains tort reform. There is a tendency among some regulators and legislators to adopt the expeditious approach of forcing insurers to write insurance coverage, either on an assigned risk or a pooled basis. This solves the immediate availability problem at no apparent cost to the public treasury and with no need to address the difficult task of reforming the tort liability system.

Structuring alternative insurance mechanisms addresses a symptom rather than the cause of the current commercial casualty insurance availability and affordability situation. Although alternative insurance mechanisms may be necessary in order to respond to federal and state financial responsibility requirements, a thorough review of common law decisions and state and federal statutory liability concepts is essential if commercial casualty insurance is to be both affordable and available in the future.

Senator **Bumpers**. That's an amazing statement. Do you feel a little bit like the illegitimate child at the family picnic?

Mr. **Martin**. Yes, sir.

Senator **Bumpers**. Mr. Habush.

STATEMENT OF ROBERT L. HABUSH, ATTORNEY, MILWAUKEE, WI; REPRESENTING THE ASSOCIATION OF TRIAL LAWYERS OF AMERICA

Mr. **Habush**. Mr. Chairman, I want to thank you for the opportunity given to me to appear before this committee. I represent 60,000 trial lawyers in the United States and Canada, and I'd also like to feel—like yourself—that I represent the victims of negligent conduct as well, since they do not have a lobby.

I think there has been an awful lot of rhetoric on all sides of this issue, and a great deal more heat than light has been generated. But I'd like to put aside the rhetoric, if I can, and just talk to you today in summary fashion, not quoting extensively from my report, which we have filed, but just to give you some thoughts on this whole subject from the point of view of a trial lawyer.

Has everyone in America become suddenly a bad risk? How is it that, all of a sudden, people who have never had claims filed against them—homeowners, day care centers, small businesses—are now considered bad risks? That puzzles me. And I think that when you examine the report that we have filed with you, Senator, and with the committee, that you will see that what has been going on in the last 2 years due to the mystique of insurance company accounting is primarily an insurance problem. And I would like to, if I can, just in a few moments cite some information and facts which might put a little different spin on the ball than you've heard or than the committee has heard this morning.

The ISO, which is the Insurance Services Office, has been quoted as saying that the property/casualty industry must accept the major responsibility for its current financial crisis. This is out of a document which the ISO published called, "1985: A Critical Year."

A gloomy prediction which occurred in December 1985, that the property/casualty industry would lose $5 billion in 1985, has now been turned around to an admission that they will earn a net profit after taxes of $1.7 billion.

Best's, which is the authoritative magazine for insurers, published by A. M. Best Co., in its January 1986 issue has advised that if you take into consideration capital gains, Federal tax credits, and increased investment value, the net worth of the industry will increase $7.6 billion in 1985. The Insurance Information Institute has reported, in their 1984–85 publication, that the assets have increased $15 billion from 1983 to 1984—which was their worst year in history—and the assets from 1955 to 1984, Senator, have increased from $22 billion to $267 billion. And that's the property/casualty segment alone.

The U.S. General Accounting Office has reported that property/casualty carriers from 1974 to 1983, on profits of $72 billion, paid only $1.3 billion in taxes, an astounding rate of 2 percent.

Senator **Bumpers**. How much?

Mr. **Habush**. Two percent.

Senator Bumpers. I know, but what was the dollar amount?

Mr. Habush. It was $1.3 billion on a profit of $72 billion.

Now, what is even more curious, Senator, is that you've heard a lot of talk about tort reform. And I invite that consideration. I invite a look at the facts and not rhetoric.

If I were to tell you of a system that has a $100,000 pain and suffering restriction, no contingent fees, nonjury trials, and virtually no punitive damages awarded other than in intentional torts, and then I were to tell you that the insurance industry in that system has refused insurance coverage for day care centers, school boards, ski teams, the City of Toronto and other cities, and raised premiums several hundred percent—and in some instances, 1,000 percent—you would probably think I was nuts. But let me tell you, Senator—and we will submit this to the committee, with your permission—the Province of Ontario is the place I've just described. And in the Province of Ontario, the headlines scream, "Liability Coverage Crunch May Shut Day Care Center," "Higher Insurance Rates Get School Bus Operators," and so on and so forth. There's a $100,000 limit on pain and suffering; there are no contingent fees; there is no punitive damages; there is no jury trial. But they have the same insurance crisis in Ontario as we have here in the States.

[Subsequent information was received and follows:]

COMPARISONS BETWEEN "TORT REFORMS" SOUGHT BY THE INSURANCE INDUSTRY AND THE LAW OF ONTARIO, CANADA

In most of the 50 states, the insurance industry is seeking legislation that would make it more difficult for injured people to win lawsuits and would limit the amount of money they could recover if they do win. The law of Ontario, Canada (where the insurance industry is raising rates just as it is in the United States, see Chart 2) already contains the provisions the insurance industry seeks, as the following chart shows:

The insurance industry wants:	Ontario, Canada has:
A. Caps on compensation for pain and suffering — e.g., for quadriplegia or brain damage — typically of $250,000.	A. Caps on compensation for pain and suffering. Ontario has a cap of $100,00 in 1978 Canadian dollars ($185,000 in current Canadian dollars). See Andrews v. Grand and Toy Alberta Ltd., 2 S.C.R. 229 (1978); Ontario Law Reform Commission Report on Products Liability, at 62 (1979) (hereinafter "Ontario Law").
B. Restrictions on punitive damages: e.g., limiting punitive damages to a specific amount or a specific multiple of the compensatory award, or absolutely prohibiting punitive damages.	B. Restrictions on punitive damages. In Canada, punitive damages are virtually unknown in tort cases. They are allowed only for intentional torts. Ontario Law at 75; Linden, Canadian Tort Law, at 49-51(1977).
C. A prohibition on injured people specifying the amount they seek in the complaint (in legal jargon, eliminating the *ad damnus* clause).	C. A prohibition on injured people specifying the amount they seek in the complaint. In Ontario, the plaintiff is not permitted to demand a specific amount in the complaint. See Gray v. Alanco Development, Inc., 1 O.R. 597 (1967); Ontario Law at 75.
D. Restrictions on contingency fees — e.g., by establishing a sliding scale that reduces the percentage of thw award the lawyer can receive as the award gets larger.	D. No contingency fees. In Ontario, contingency fees are prohibited. Ontario Law at 72, 75.
E. Restrictions on the role of the jury — e.g., taking the authority to determine the amount of punitive damages away from the jury, or requiring the jury to answer detailed interrogatories that limit its discretion.	E. Restrictions on the role of the jury. There is no constitutional right to a jury trial in Canada. Most trials are judge trials. Ontario Law at 74, 102-04.

F. Penalties for "frivolous" suits -- e.g., requiring the plaintiff to pay the cost of defending such a suit.	F. Penalties for "frivolous" suits. In Ontario, if the plaintiff loses he must pay the defendant's attorney's fees, as well as his own. Ontario Law at 72, 76.

WHAT HAPPENS TO INSURANCE RATES WHEN "TORT REFORM" LEGISLATION IS ENACTED?

Virtually every "tort reform" measure the insurance industry is seeking is currently the law in Ontario, Canada (See Chart 1). Yet the insurance industry is raising premiums by 400%, cancelling coverage in mid-term and refusing to provide coverage at any price in Ontario, Canada just as it is in the United States. For example:

- The insurance industry has refused to provide insurance at any price for Ontario day care centers (See Exhibit 1).

- The insurance industry has refused to provide insurance at any price to all but 1 of 121 Canadian School Boards responding to a questionnaire (See Exhibit 2).

- The insurance industry has refused to provide liability insurance for Toronto and many other cities (See Exhibit 3).

- The insurance industry has refused to provide liability insurance at any price to the Canadian national ski teams, which have never had a major claim against them (See Exhibit 4).

- The insurance industry has raised premiums 1000% and at the same time reduced coverage for the Ontario intercity bus industry (See Exhibit 5).

- Hospitals in Toronto can still get insurance, but only at "greatly increased" premiums (See Exhibit 6).

- An insurance company renewed the Ontario School Bus Operators Association's policy on December 1 -- at 400% more than it charged the year before (See Exhibit 1).

If any of the organizations denied coverage were ever sued -- and many of them have never been sued in the past -- they would be sued under the laws of Ontario, where pain and suffering awards are capped at $185,000, punitive damages are virtually non-existent, contingency fees are prohibited and the plaintiff must pay the defendant's attorney's fees if he loses. Yet the insurance industry is raising its rates 400% and more, cancelling policies in mid-term and refusing to provide coverage at any price both in the U.S., which has not enacted the tort provisions the industry seeks, and in Ontario, Canada, where such provisions have long been in the law.

Exhibit 1

Toronto Star
Friday, January 10, 1986

Liability coverage crunch may shut day-care agencies

By Elaine Carey Toronto Star

Two of the largest day-care agencies in Metro may be forced to close down next month because they have been unable to renew their liability insurance.

Family Day Care Services, which provides care for about 600 children through home care and a school-age centre, and Cradleship Creche, which cares for another 550 children, say they can't get insurance at any cost.

Cradleship's policy expires Jan. 31 while Family Day Care has until the end of February to try to find some solution, said John Pepin, its executive director.

"But our agent and two others have been trying everywhere and there just isn't anything," he said. "If it's hitting us this way, it will eventually hit the others as well."

'Pay 1,000 per cent'

Family Day Care, one of the oldest registered charities in Canada, has been in operation for 135 years and has never had an insurance claim, he said. Its premiums rose 65 per cent last year to about $2,500 but this year the insurer refused to renew the policy.

"At this point we are willing to pay 1,000 per cent more if necessary, but we can't even get a quote," he said.

Dr. Myrna Francis, executive director of Cradleship Creche — which has operated for almost 50 years without a claim — said their insurer refused to renew their policy when it expired Dec. 31, but granted them a month's extension to try to find other insurance. But insurers simply say they will no longer issue policies to day-care centres.

The provincial Day Nurseries Act requires day-care centres to have liability insurance to operate, she said, and they have informed the province of the situation.

'Deficit financing'

"We are just waiting to hear form the government and we will very shortly have to decide what course of action to take," she said.

Pepin said the implications of putting 1,150 children out of day care are "horrendous. Most of these people are low-income and without day care they would lose their jobs.

"Even if we do get some kind of ministerial approval to operate without insurance, if there was ever a suit and we're not protected, we put ourselves in a very vulnerable position," he said. "We can't afford to self-insure — we have barely enough funds as it is and we end up deficit financing every year. Where would we find the funds to cover it?"

The liability insurance industry in Canada has hit a crisis because of skyrocketing court awards and falling interest rates. Many companies have simply refused to issue policies for vulnerable groups, including four of Metro's municipal governments and the Metro School Board, which are now self-insuring.

Insurers cite problems in the United States, where several day-care centres have been charged with sexually abusing children in their care, as one reason for their unwillingness to renew day-care policies.

Umbrella Day Care Coalition, which arranges insurance for 185 non-profit day-care centres in Metro, did manage to get insurance Oct. 1 for only a slight premium increase, "but we had to stay away totally from American insurance companies," director Jund Hall said.

The U.S. company they had been dealing with for years refused to renew at all, she said, and up until a week before the policy expired "no one would touch it." The coalition eventually found a British insurer who was willing to take on the policy.

But Pepin said that company and others willing to renew policies two months ago are now flatly refusing, claiming that one suit involving a small child could cost them millions.

"I think, as all these day-care organizations come up for renewal, they will find enormous problems," he said.

Higher insurance rates hit school bus operators

By Kim Zarzour Toronto Star

School bus companies and school boards are bracing themselves for hefty vehicle insurance increases that threaten to put some smaller bus operations out of business.

If school boards don't take the brunt of the increase, officials say, parents may have to find another way to get their children back and forth to school.

Metro area boards spent about $70 million transporting more than 123,000 students last year. Board officials say the cost of that service will increase considerably when the new busing contracts are negotiated in the spring.

Insurance companies blame the higher rates — which are also causing problems for municipalities, school boards and trucking companies — on increasing frequency and cost of claims and higher court awards to accident victims.

Bus operators and school boards said yesterday that the situation took them by surprise.

"It just seemed to hit us in November and December," said Ted Moorhead, president of the School Bus Operators Association of Ontario. Moorhead said he was shocked by a 400 per cent increase when he renewed his insurance Dec. 1.

Charter bus companies have already been hit with big jumps in insurance rates. Gray Coach Lines Ltd. recently hiked the price of monthly commuter passes to cover higher liability insurance premiums. The Ontario Motor Coach Association has called for an investigation by a legislative committee.

Moorhead said most school bus operators haven't yet been hit by the increases, but they fear it's inevitable.

While some operators say the increases will be no more damaging than the soaring gas prices of recent years, others, especially the smaller companies, are worried.

"I can't take any large increases without going bankrupt. If it goes up 100 or 200 per cent, then I'll have to think about closing my doors," said Ronald Young, who operates a fleet of 50 buses for the Peel Board of Education. "The school board is going to have to bear the brunt of the increase, and they in turn will have to pass it on to the taxpayers."

William McWhirter, transportation officer with the Toronto board, said school boards will just have to find the money somewhere.

"If we don't realize that the whole industry is in trouble and try to help them out, then we're not going to have any transportation service at all."

The bus operators association has scheduled a meeting to discuss the insurance problem next week.

Exhibit 2

[illegible]

416/963-0311

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M7A 2H6

Ministry of
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Relations

BACKGROUND NOTES - January 9, 1986

SUBJECT: LIABILITY INSURANCE

INSURANCE CLASS: SCHOOL BOARDS

121 of the 165 boards (excluding Canadian Forces Board and Treatment Centres) responded to an insurance questionnaire distributed in early December 1985 and at this time only one board has been unable to obtain liability insurance coverage at all. The board is the Moose Factory Island District High School Area.

Several boards have had to reduce the maximum liability insurance coverage that was available to them last year.

The premium increases have ranged from a low of 12% to a high of 563% over the previous year's premium.

Several boards have indicated that new exclusions have been imposed on them by the insurance industry, such as sports related activities, shop programs, and environmental issues. At this time the only boards to have advised us that this has been given to them in writing by their insurance broker are the Wellington County Board of Education and the Kirkland Lake Board of Education. The Wellington County Board of Education has halted all physical education programs until further notice.

We are currently working with the Ontario Association of School Business Officials to review that options are available to school boards to solve this problem.

No board is expected to close because of a lack of insurance.

The Ontario Association of School Business Officials has been trying for some time to arrange a co-operative for school boards under which they would insure each other. Planning for this continues, and OASBO has asked for Ministry of Education assistance in collecting the required data. The Ministry is considering this request, which includes a request for financial assistance (about $25,000).

An inter-ministry work group has been formed to examine the entire insurance situation, led by Consumer and Commercial Relations. The Ministry of Education has representation on this committee.

BEST

Exhibit 3

Toronto Star
Friday, January 10, 1986

'Crisis' team to investigate soaring price of insurance

By Denise Harrington Toronto Star

A provincial task force will look at government-run coverage and tougher insurance regulations in a bid to solve the crisis of soaring premiums facing Ontario cities, school boards and hospitals.

"This government is not prepared to stand aside while this crisis threatens some elements of our economic and social system," Consumer Minister Monte Kwinter told the Legislature yesterday.

The task force, under former Economic Council of Canada chairman David Slater, will examine the costs and availability of liability insurance in Ontario and whether rules governing the industry could be improved to ensure stable rates.

Kwinter also announced yesterday a new plan to pay limited compensation to customers of bankrupt insurance companies.

The government will help hospitals pay for massive premium increases if they face "true financial hardship," Kwinter promised.

Replying to questions in the Legislature, Kwinter said the Liberal government is not considering offering automobile insurance or public sickness and disability insurance.

☐ Metro day-care agencies may close without insurance. Page A4.

"At the present time the government's preference is not to be in the insurance business," Kwinter added outside the Legislature.

"On the other hand, if the case can be made, and if it can be documented that this would be the route to go and makes economic sense and provides the kind of services required, we would certainly look at it."

Metro and the municipalities of Toronto, York, Etobicoke and East York have been unable to get any insurance coverage against personal injury for 1986. The province is encouraging municipalities to set up insurance pools to handle soaring rates and lack of coverage.

'Doing nothing'

Opposition Leader Larry Grossman complained that Kwinter has, "after six months of literally doing nothing," decided to appoint a task force "that will take a minimum of another three months before anything happens."

New Democratic Party leader Bob Rae said the government should introduce a sickness and disability insurance plan for all Ontarians, as well as an auto insurance scheme similar to those in Manitoba and Saskatchewan.

But Kwinter pointed out public insurance plans in those two provinces were facing deficits this year. He said the problem of soaring premiums was worldwide because of high court awards, low interest rates paid on investment on premiums, and competitive cut-rate premiums offered several years ago.

Outside the Legislature, Kwinter said the government will set up a plan to provide a maximum of $200,000 in coverage to customers of companies that go bankrupt. All
panies will be asked to pay into
und at rates to be set later.

Exhibit 4

Globe & Mail
Jan. 15/86

Insurance problems may curtail season for Canadian skiers

Special and Canadian Press
OTTAWA

Canada's national ski teams may have to leave the World Cup circuit at the end of this month because of an insurance problem that could also cripple competitive skiing across Canada.

Ken Payment, executive director of the Canadian Ski Association, says the inability to get sufficient liability insurance may force the association not only to call home its national teams but also to cancel all domestic competitions.

Most provincial ski programs and some club programs would also be affected, since they are tied to the CSA's insurance policy. The CSA executive plans an emergency meeting on Jan. 25 in Ottawa.

Glenn Wurtele, the national head coach, said yesterday in Kitzbuehel, Austria, that he hadn't been told that the teams might be called home or even that there is an insurance problem.

"It certainly is news to me. I find it extremely hard to even envision it happening; I really can't imagine something happening on that scale."

Mr. Wurtele said he could not see Sport Canada, with its huge investment in Olympic sports, allowing the teams to be called home.

The association is one of a growing group of sports organizations finding it difficult to purchase liability insurance at an affordable cost.

The CSA says it was first told that the price of liability insurance would double, and then found that coverage was unavailable at any price.

The association's current coverage on national alpine, cross-country, jumping, free-style, biathlon and nordic combined skiers, coaches and staff ends on Jan. 29, after several extensions by the New York-based American Home Assur-

SKI — Page A2

Ski teams can't get liability insurance

● From Page One

ance Co.

"I'm not sure what will happen after that," Mr. Payment said yesterday. "The odds are good we won't have insurance. The executive must decide what to do.

"If we don't find re-insurers . . . it could mean recalling all the teams and it could affect all of our developing teams leading to 1988," the year of the Winter Olympics in Calgary.

Mr. Payment said he understands that U.S. teams may also be having insurance problems. He said, however, that European ski teams don't face the sort of problem confronting Canadian teams, at least in part because accident settlements tend to be lower in Europe.

He said he has been trying to get more information on the European situation to see if he can glean any pointers to help Canadian ski teams deal with their difficulties.

CSA was first advised by its insurance agent it could expect to pay between $50,000 and $100,000 for $10-million in liability insurance for 1986. Mr. Payment said the CSA, which has never had a major liability claim against it, was willing to pay that amount, but later found that insurance companies had backed away from offering liability insurance at any price.

In 1984, the CSA paid $7,000 for liability insurance, with the premium rising to $47,000 last year.

Mr. Payment said the association has been unable to find coverage from any of about 100 companies it has approached. That leaves the association with the option of going through the remaining three months of the season without liability insurance.

"If we had no insurance, it would expose the coaches and staff to (possible) lawsuits and we could have mass resignations," Mr. Payment said. "Some volunteers have indicated they will resign if there is no insurance."

The CSA is considering buying accident insurance for the skiers, but that is expensive and it does not cover the volunteers, coaches, staff and the association.

"If a skier becomes paralyzed, accident insurance may pay $250,000, but he may decide to sue. A settlement of a few million isn't unusual."

The increased difficulty of getting adequate liability insurance, a result of large claim settlements in North America, has affected all Canadian amateur sports organizations.

Hugh Glynn, president of the National Sport and Recreation Centre, had no instant remedy, but said the problem needs immediate attention. He said he informed Otto Jelinek, the Minister of Fitness and Amateur Sport, about the situation before Christmas, but has not had a reply.

"One thing is for certain: the Government must step in. They will bring volunteer organizations to a standstill, if they keep this up. It appears to be a pressure tactic (by the insurance companies) to bring action from the Government.

"Our organizations have gone as far as Lloyds of London and they have turned us down."

Rob Toller, a spokesman for Mr. Jelinek, said on Monday that the minister was extremely concerned about the situation and was "seeking the best advice he could find" from the sports community and the insurance industry.

"But really, he doesn't know just what he can do to ease the situation."

Barbara McDougall, Minister of State for Finance, indicated in Parliament on Monday that she will be bringing in new policies to deal with the general problem of liability insurance, but she did not elaborate on what those initiatives would be. A special committee of the Ontario Legislature already has been struck to study the situation.

Exhibit 5

[illegible]

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Ministry of
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BACKGROUND NOTES - JANUARY 9, 1986

SUBJECT: LIABILITY INSURANCE

INSURANCE CLASS: BUSES

Since the OMCA wrote the Premier on September 18the. senior staff from MTC and CCR have been involved in meetings and initiatives aimed at assisting the bus industry. Notably, arrangements were made with the Facility Association to provide insurance coverage for this industry, the Honourable Ed Fulton has met with the OMCA and has gained insight into the insurance crisis from the industry's perspective, and the Deputies from MTC, CCR, and Tourism and Recreation have met to seek solutions to this problem.

The Deputy Minister of CCR met with representative from the Ontario Motor Coach Association on November 23, 1985.

EFFECTIVE IMMEDIATELY bus carrier tariff increases will be approved by the Minister MTC without referral to the OHTB. This will allow tariff increases due to insurance premium increases to be approved in a week instead of the previous 30-60days.

The intercity bus industry in Ontario is facing increased costs of liability insurance. Premiums have increased ten-fold from levels of $2000-3000 per coach to $20000-24000 per coach for much less coverage.

Exhibit 6

[illegible]

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Ministry of
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BACKGROUND NOTES - January 9, 1986

SUBJECT: LIABILITY INSURANCE

INSURANCE CLASS: HOSPITALS

In June of 1985, the Ministry of Health became aware of a major price increase in hospital liability insurance.

July 8, 1985, the staff of the Ministry of Health met with representatives of the Ontario Hospital Association and their insurance brokers.

Both the Ministry of Health and the O.H.A. met with the Superintendent of Insurance subsequently to review options/alternatives that might be available.

The Ontario Hospital Association has established a Task Force, including an observer from the Ministry of Health to review the alternatives available to the industry. The review will include examination of options such as self insurance, change in coverage from occurrence to claims made, etc.

A group of 20 Metro Toronto hospitals are conducting a similar, but independent, review.

The hospitals of the Province are still able to purchase liability insurance, although at a greatly increased premium.

In terms of the increased premiums, the Ministry of Health has not made any overall provision for the costs but is reviewing each hospital's overall financial position and is prepared to provide additional funds in cases of true financial hardship.

Mr. HABUSH. In Wisconsin, we have a $50,000 cap on municipal governmental units', villages', and towns' liability, it had been a $25,000 cap until recently. There are similar restrictions in Pennsylvania and in Florida. In Wisconsin, a few months ago, 41 counties had their insurance completely pulled away. No coverage; bare. This is with a cap that's been in existence since the early 1960's, and the only exposure that these governmental units are subjected to are motor vehicle accidents—which are covered by standard auto policies—and what they call "1983 police brutality cases."

Senator BUMPERS. Was that a $50,000 pain and suffering limitation?

Mr. HABUSH. Total recovery, Senator.

Senator BUMPERS. Total recovery?

Mr. HABUSH. Total recovery.

Senator BUMPERS. Total recovery. And how long has that been on the books?

Mr. HABUSH. Since 1963 or 1964. It was $25,000 until a couple of years ago, when they raised it to $50,000. And in Pennsylvania, they have equally restrictive coverages and they have the same type of insurance unavailability and affordability crisis there. Now, I don't understand how that happens.

I testified in front of Tom Fox's committee in Wisconsin, the one that was referred to in the prior testimony. And when I was through the director, Stanley York of the League of Municipalities—whom I know—said, "Bob, I don't understand why I can't get insurance for my counties here in Wisconsin when we have this cap, and we've had it since the early 1960's." And my response was, "I don't understand it either. I suggest you ask the president of Milwaukee Mutual, who is sitting next to you, why you can't get it."

Senator BUMPERS. Let me ask—I hate to interrupt you, Mr. Habush, in your testimony. But along that line, have you done any research on how many lawsuits have been filed against the counties now, as compared to—say—the 1960's and early 1970's?

Mr. HABUSH. No. We are commissioning a study—I don't know if that information is available. I think that it's fair to say, Senator, that where the doctrine of sovereign immunity or governmental immunity has been eliminated, that has increased the number of cases.

I think it's also correct to say that there have been more cases against governmental units for police brutality and violations of civil rights than there have been in the past. But my point is that even in States that have the severest of restrictions—much more severe than anyone has even proposed—it hasn't prevented an insurance company from totally withdrawing from the market, willy-nilly, if they decide they don't want to write the insurance any more.

Now, the tort system isn't perfect. But there have been some studies conducted which are more than just rhetoric. There was a Rand Corp. study from the Institute of Civil Justice which reported in November 1985, and I quote: "Our research shows that juries are usually sensible and their decisions have been remarkably stable over 20 years." Now, this is the Rand Corp., which basically has been doing all the authoritative studies on behalf of most of the insurance companies.

The University of Wisconsin—two law professors—did a study which was published in the UCLA Law Review which indicated that 50 percent of claims are less than $10,000, and that only 12 percent of claims filed are more than $50,000; and that the large case is really quite rare.

The Honorable James Florio, who is chair of the House Subcommittee on Commerce, Transportation, and Tourism, in January 1986 was quoted as saying,

> My subcommittee has not been provided with data that proves that the broad scope of the insurance crisis is attributable to runaway judges and juries.

In Best's, that same magazine that I cited earlier, in February 1986, it was said,

> Insurers were trying to increase market share and generate greater premium volume to take advantage of record interest rates, and they spawned a savage price war.

It has been stated by the president of the American Insurance Association, Mr. Cheek, on November 8, 1985, that prices today are back to their 1977-78 level when adjusted for inflation. That's how low they were; they're just back to 1977-78 when adjusted for inflation. And there are reports that 1986 is going to be a banner year for insurance companies. Insurance stocks are the hottest stocks on the stock market right now, outperforming all other stocks for future investors.

Mr. Chairman, what we have seen here is catchup. What we have seen here is hysterical underwriters who read about a case for child abuse in California and decide that all day care centers are bad risks. An underwriter or underwriters who read about some midwives being sued for midwife malpractice and decide they are all bad risks. Underwriters who decide that their surplus requires them to pull out of some less profitable lines, so they completely withdraw from the market. And it cuts across the entire segment of the society, including lawyers. Lawyers all over the country are having difficulty getting legal malpractice insurance, as well, and so it's not just the accountants or the architects.

Let me just read a quote to you, Senator, which is from the Journal of Commerce, June 18, 1985, attributable to an insurance company executive: "It is right for the industry to withdraw and let pressures build in the courts and in the State legislatures."

I suggest to you that this massive dislocation in the marketplace is doing just that, and I caution—I caution— the lawmakers to examine this very carefully. And when you look at States and jurisdictions and provinces where there are already severe restrictions on tort, and you see the same insurance problems, the inescapable conclusion is that this is essentially an insurance problem.

Now, I believe that the McCarran-Ferguson antitrust immunity must be eliminated. There has been a total lack of State regulation by State insurance commissioners. There must be Federal intervention in this respect.

Second, you should give encouragement to self-insurers. You should create tax advantages so people can self-insure and create their own insurance funds.

Third, I think there should be prior approval of rates, and that insurers should be required to place a band around their rates so that they cannot increase or decrease filed rates more than a certain percentage from the consumer price index.

I think there should be the creation of joint underwriting associations, funded by the insurance companies writing business in the States, which would kick in automatically if 5 percent of the standard risks in the State could not get insurance in the private sector.

And finally, I think that there should be the formation of citizen insurance boards like the citizen utility boards, so that the citizens of this country can have some type of advocate overseeing the insurance industry since it seems to me that the industry has indicated by its conduct that it will not act responsibly without such overseeing by the public.

I hope, Mr. Chairman, that I've given a little different spin on the ball than perhaps you've heard before. In our paper, we've indicated where we believe reserve manipulation has occurred. We have shown you in our paper where the industry has actually reduced loss reserves—reduced loss reserves during a period of time insurers were trying to put business on the books and they were trying to increase the surplus.

So I invite examination of the entire system, both insurance and the tort system. And again, I thank you for the opportunity.

[The prepared statement of Mr. Habush follows:]

STATEMENT OF ROBERT HABUSH, PRESIDENT-ELECT, ASSOCIATION OF TRIAL LAWYERS OF AMERICA

INTRODUCTION

Across the country businesses, professions, organizations, and governmental units, among others, are crying out for radical changes to the civil justice system which are described as reforms. These suggested changes are restrictions on recoveries and attorneys' fees. The entire movement was precipitated by the conduct of the insurance industry which made insurance both unavailable and unaffordable to thousands of insureds.

The insurance industry, in an effort to justify their conduct, blamed the civil justice system for its actions and advised the American public that unless there were serious cutbacks in the rights of injured people to recover damages, insurance would remain unavailable and unaffordable.

There have been several lonely voices in the wilderness that have attempted to inform the public, including the legislators and lawmakers, that the problems currently faced by the industry are due to its own mismanagement and underpricing of insurance products.

There is an assumption that the property/casualty insurance industry has been and is in deep financial trouble and that the requested reforms are necessary to preserve an industry that is ill from the ravages of an out-of-control civil justice system.

An additional assumption was that recent premium increases and unavailability of insurance was also due to the legal system. Both assumptions are completely false. The fact is that for the past several decades the insurance industry has generally done very well and even in times of heavy underwriting losses due to inadequate premium prices there were increases in overall assets and an adequate return on net worth. Moreover, it appears clear that the insurance industry, indeed, will do very well in 1986 and that the property/casualty stocks on the stock market have become very attractive investments.

In December, 1985, headlines across the country screamed, "Underwriting Loss for Property/Casualty Industry Hits New Highs". The statement was patently deceptive. Although it is true that due to the insurance companies' peculiar accounting methods there was an underwriting loss anticipated by the insurance industry, it was not true that the net profit after taxes would be a loss of $5.5 Billion. The truth and the fact is that for 1985 there should be a $1.7 Billion net profit after taxes for the property/casualty industry. This was disclosed by The Insurance Information Institute after Ralph Nader and Robert Hunter, of The National Insurance Consumers' Organization, drew attention to the false predictions for 1985. It is also true that if the estimated $2.1 Billion in policyholder dividends is added back into income, the net profit after taxes for 1985 would be $3.8 Billion. A far cry from the claim of a $5.5 Billion loss. (Washington Post, Tuesday, January 14, 1986, article by Sari Horwitz).

What is it about property/casualty insurance practices that are so mysterious and misunderstood so as to permit this massive deception of the American insurance-buying public?

In the discussion and illustrations which follow, the mystique will be stripped aside and the truth will become very clear: insurance company accounting methods, business practices, and cyclical influences - not the justice system - have been the cause of the recent crisis in the liability insurance marketplace.

INSURANCE COMPANY

In order to appreciate reserving practices, it is necessary to examine the make up of an insurance company.

Property/Casualty Insurance Company

Business

Income is derived from:

A. premiums;

B. additions to income by reducing old claim reserve estimates.

Losses occur from:

A. losses actually paid to claimants;

B. new case estimates for future payments (reserves);

C. increases in old claim reserves;

D. the cost of handling claims (adjustors, investigators, lawyers, etc.);

E. cost of administration of the insurance company (clerks, typists, etc.).

Investment

Investment earnings are realized from:

A. interest and dividends from investments;

B. capital gains from sales of stocks and/or bonds (premiums and loss reserves are invested).

ASSETS OF PROPERTY AND CASUALTY COMPANIES HAVE GROWN STEADILY IN THE LAST 30 YEARS

Despite periodic complaints by the insurance industry of hard times, the facts are that the insurance industry's assets (property and casualty) have grown from $22 Billion in 1955 to $264 Billion in 1984. Only once in that period of time (1974) did assets fail to increase annually. (Source - Insurance Information Institute). (Chart A)

PROPERTY AND CASUALTY ASSETS
1984

YEAR	ASSETS
1955	22,304,600
1956	23,106,000
1957	23,448,700
1958	26,308,600
1959	28,601,900
1960	30,132,400
1961	33,690,100
1962	34,216,800
1963	37,076,200
1964	39,864,800
1965	41,842,900
1966	42,288,400
1967	46,561,700
1968	51,225,600
1969	52,368,800
1970	58,593,700
1971	67,284,400
1972	78,885,000
1973	83,862,400
1974	82,115,300
1975	94,118,000
1976	112,975,000
1977	135,513,000
1978	149,097,000
1979	174,228,000
1980	197,661,000
1981	212,303,000
1982	231,693,000
1983	249,121,000
1984	264,735,000

A

Assets and Liabilities

Best's Aggregates through 1984

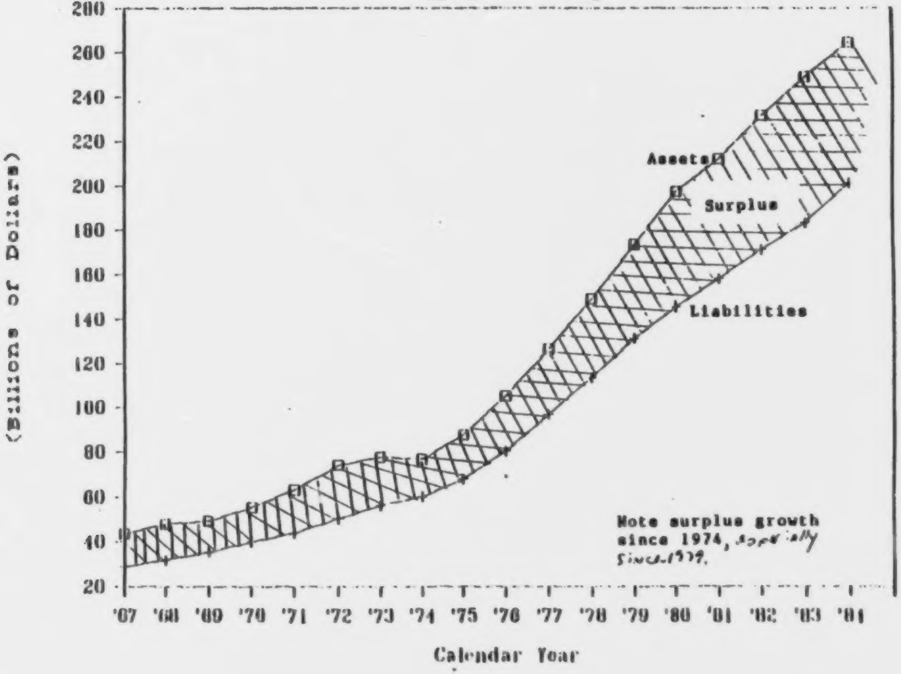


Chart C demonstrates how in the seventeen years from 1967 through 1984:

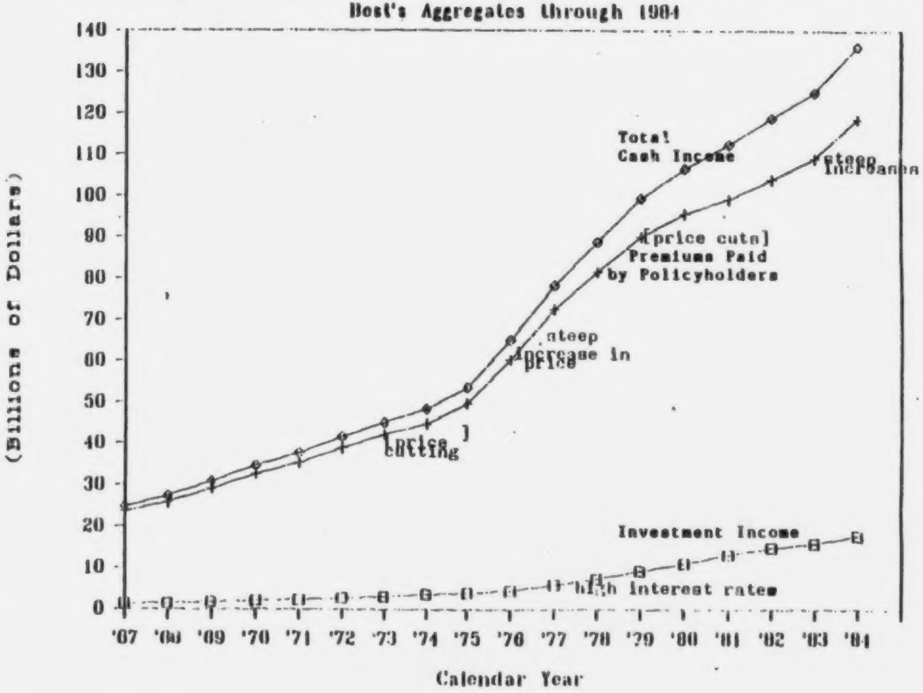
1. investment income has steadily risen, although sharply increasing in the double-digit interest-rate years of the late 1970's and early 1980's and leveling off in 1983 and 1984;

2. premiums paid (price) by policyholders have continued upward in all of the 17 years, but sharp price-cutting from 1973 through 1975 and from 1979 through 1982 are demonstrated by a leveling off of the line and a steep increase in price from 1983 through 1984. Both investment income and premiums income = total cash income.

BEST C LE

6

Premium Written and Investment Income

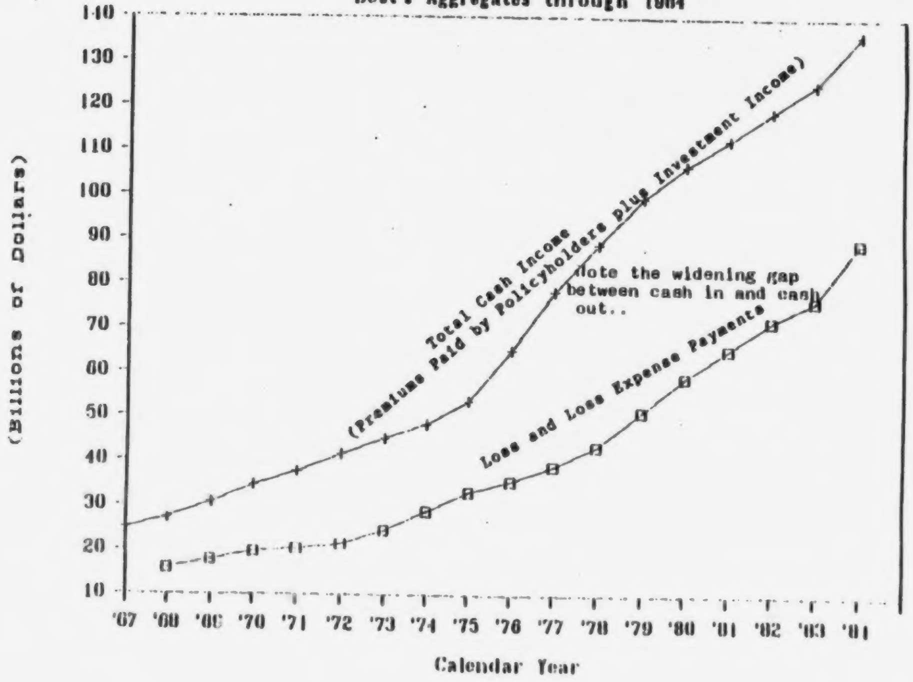


The purpose of Charts D and E is to show the extent to which total cash income (premiums paid and investment income) exceeds losses and expenses related to losses (adjustors, investigators, lawyers, etc.). Note how the gap increases from 1975 on. The same relationship exists when looking at earned premiums (always less than "written" or paid because earnings occur during premium period - not all at once on payment) and loss expense payments. (Charts D and E)

D

Cash In and Cash Out

Best's Aggregates through 1984

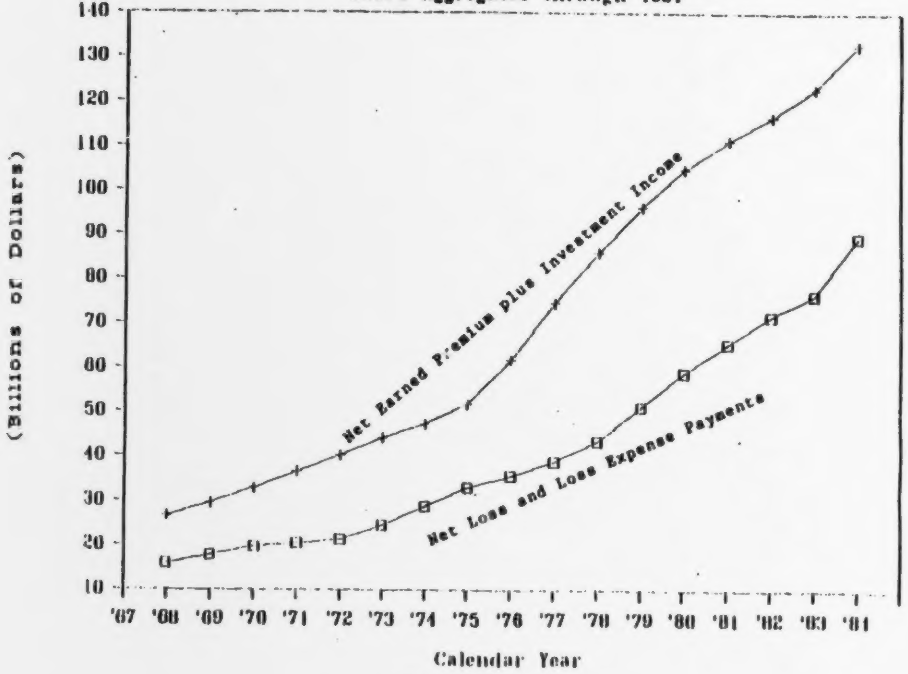


Note the widening gap between cash in and cash out..

E

Earned Premium and Loss Payments

Best's Aggregates through 1984



LOSS RESERVE MANIPULATION

The following facts are important concerning loss reserves:

1. Loss reserves are merely estimates of what might be paid in the future on reported claims. These reserves can be overestimated or underestimated.

2. When a loss reserve is established on the books, the effect is to charge current profits by that amount.

3. There is a reserve that is set periodically. That reserve is called the IBNR (incurred but not reported). This reserve charges current income for suspected losses that no one has even claimed against the company!

4. This estimating or reserving, as it is called, is vulnerable to great abuse and inaccuracy:

   a. if an insurance company desires to record greater profits, it can understate its reserves;

   b. if an insurance company desires to shelter income or report larger operating losses to justify withdrawal of business from the marketplace or to justify huge rate increases, it can overestimate reserves;

5. When these reserves are examined in subsequent years, it is demonstrated that in many cases the reserves are overestimated and, thus, a greater loss was claimed than actually occurred.

It is important to reflect on the charges by the insurers that their sharp increases in premiums and withdrawal from markets completely was due to the legal system, or awards by juries or settlements. If that were true, one would see a close relationship between increased premiums and loss payments and reserves - that is to say, the so-called "run-away" tort system would be reflected in sharp loss payment increases or reserves. One has never heard insurers claim that awards and settlements have gone down so as to justify lowering reserve estimates!

Yet, the graphs that follow illustrate:

1. Loss payments have an infrequent relationship to increased premiums, and Chart F (premiums written and loss payments) reveals sharp drops in loss payments (1975-1976) while prices (premiums) are going through the roof!

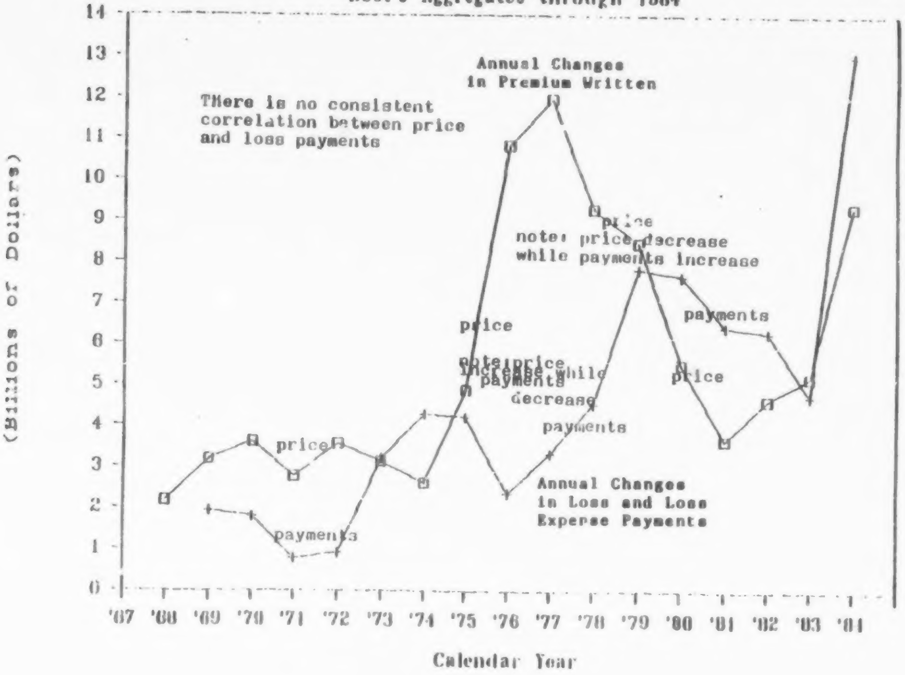
2. Then from 1977 through 1979 prices (premiums) drop like a rock (price-cutting competition) while loss payments actually increase!

Again, loss payments drop off sharply during 1979 through 1983 - during "more price-cutting" (1979-1981).

Conclusion: Prices charged are essentially a reflection of "competition" and a desire to put on business (downward line) or a desire to play "catch-up", as in 1975 and 1983. Thus, there is no relationship to loss payments or the tort system!

Premium Written and Loss Payments

Best's Aggregates through 1984



RESERVE CHANGES MAY BE INFLUENCED BY CONSIDERATIONS OTHER THAN LOSS

Since the insurers claim their past financial reversals are all due to large verdicts and payments, we would expect loss reserves to continuously go up and up and up (the insurers' estimate of what they are going to have to pay on reported and unreported losses).

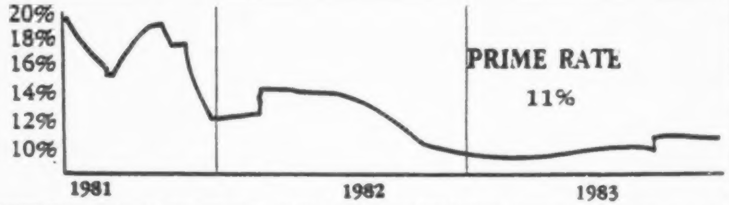
Remember, reserves are "guesstimates" and can be used to not only "cover expected future payments", but also to "shelter" income so as to eliminate taxes! From 1974 through 1983 insurers paid income tax of two percent on reported profits of $72 Billion! (Address by Natwar M. Gandhi, Group Director - Tax Policy USGAO, August 20, 1985.)

Further proof that premium increases are not influenced by losses is found in this quote from Best's, the insurers' authoritative reporting and rating service:

> "In 1984, insurance industry's own estimate of incurred loss and loss expense payments (reserves) increased by the smallest amount since 1977. Yet at the same time as the rate of growth of losses was declining, premiums (price) increased by the largest margin since 1976, over 13%." (Emphasis added.) (A. M. Best's Casualty Loss Reserve Development, 1985)

If premiums (price) were as claimed, a reflection of the underlying liability legal system, they would have risen steadily over the years in line with inflation. This did not occur! Often times the premiums plummeted or surged upward faster than inflation!

This chart shows why from 1977 through 1981 there was a scramble by insurers for market share to "invest".



**NOTE: The prime rate is currently 9.5%. As the chart above might indicate, property and casualty insurers have seen the income that can be earned on the investment of premium dollars cut in hope that investment income will rise to improve the corporate bottom line.*

PREMIUMS WRITTEN AND RESERVES

Chart G presents dramatic evidence of "reserve manipulation" and refutes the lie that only the legal system affects income, reserving and surplus. It can be seen in the time frame of 1977 through 1983 that the price line drops off sharply beginning in 1977 as the companies' lust for business causes them to cut prices (premiums). Isn't it interesting that the "reserve" change line drops sharply from 1979 through 1982 - with all of this claimed "explosion" in settlements and jury verdicts in a society awash in "litigiousness"!

Why? How much business an insurer can put on the books is determined by a ratio of the "written premiums" to the surplus. If you are putting alot of new business on the books, it may be important to "beef up" surplus, and the easiest way to do this is to drop your reserves because the amount cut goes into the surplus.

Note on Chart H that the loss reserves drop in 1979 through 1982 and there is a sharp increase in surplus in 1979 through 1980 and again in 1981 through 1982.

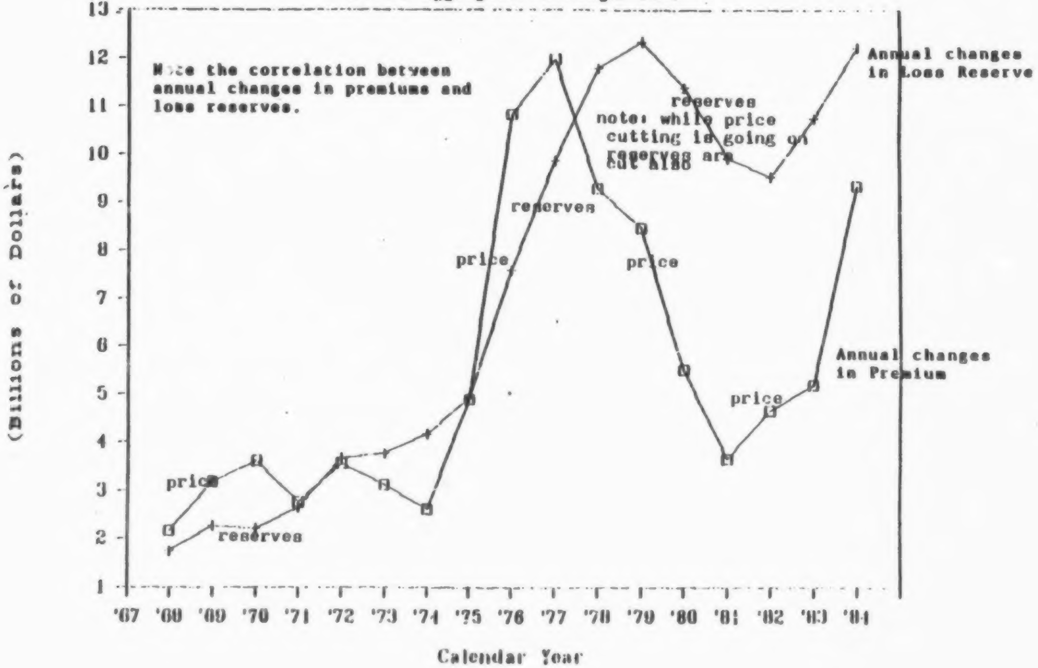
In 1984 they got "caught" - reserves previously depleted had to be beefed up and the surplus went down because investment income could not "carry" losses created due to the foolish price level of 1977 through 1983.

Chart I shows the relationship between "reserve manipulation" and "profit and loss". Some of the suspected "sheltering" is shown in the rise of the top line (loss reserves) while profits

G

Premium Written and Reserves

Best's Aggregates through 1984

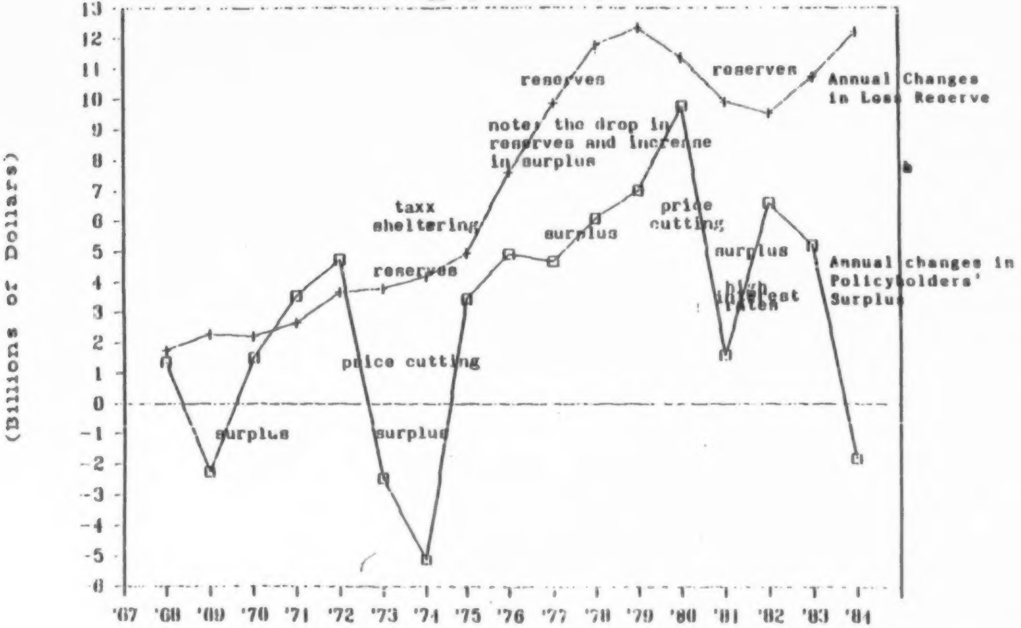


Note the correlation between annual changes in premiums and loss reserves.

note: while price cutting is going on reserves are cut also

Policyholders' Surplus and Reserves

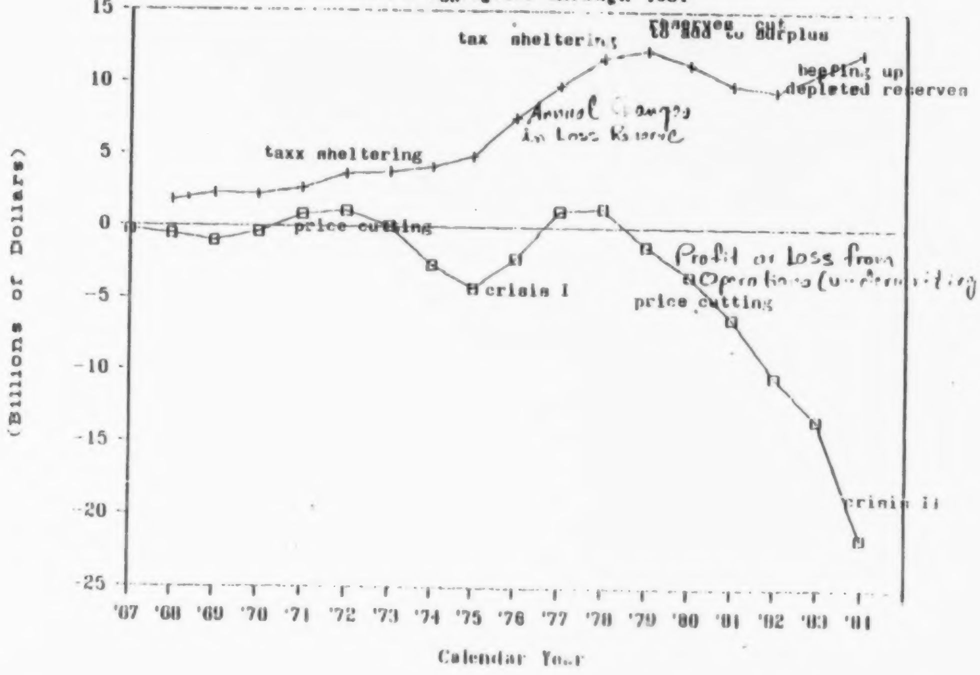
Best's Aggregates through 1984



I

Profit--Loss and Reserves

Best's Aggregates through 1984



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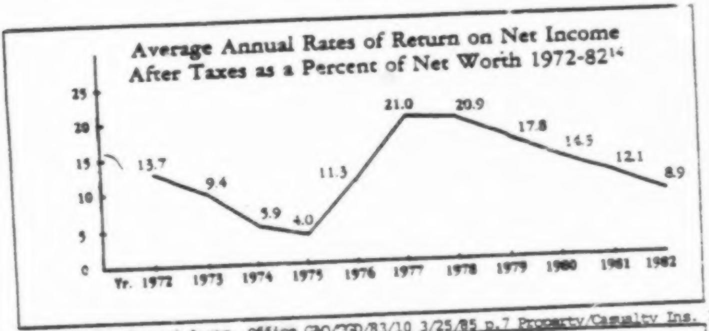
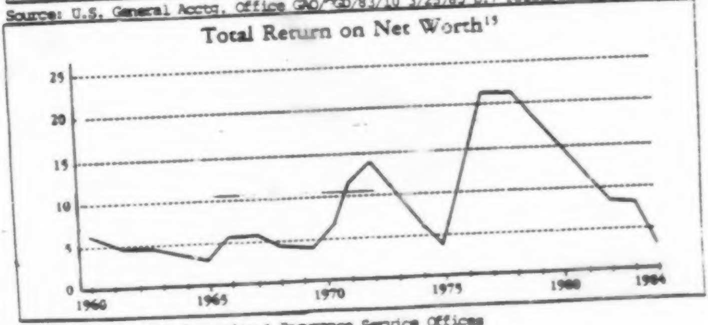
rose in 1977 and 1978. Again in 1979 through 1982 there was a loss reserve depletion during the period of price-cutting. The operational loss continued due to foolish pricing!

Despite all of these peaks and valleys, there still has been a return on net worth through 1984.


Average Annual Rates of Return on Net Income After Taxes as a Percent of Net Worth 1972-82[14]

Source: U.S. General Acctg. Office GAO/GGD/83/10 3/25/85 p.7 Property/Casualty Ins. Ind


Total Return on Net Worth[15]

Source - Citibank Economics & Insurance Service Offices

What is happening now?

> "Companies are doing what they feel they have to to get back to price adequacy . . . competitive pressure drove rates down for many years. Generally prices today are coming back to what they were in 1977 or 1978 when adjusted for inflation." (Emphasis added.) Grover Czech, Regional Vice President, American Insurance Association, Pittsburgh Post Gazette, November 8, 1985.

The National Association of Independent Insurers and Insurance Services Office, in "1985, A Critical Year", concluded:

> "The property/casualty industry must accept the major responsibility for its current financial condition." (Emphasis added.)

However, do not mourn for the property/casualty industry.

Michael E. Hogue, President of Philadelphia Insurance Research Group, at the convention of The National Association of Professional Insurance Agents as reported in National Underwriter on November 8, 1985, stated:

> "The property-casualty insurance industry today is in a stronger capital and surplus position than it has ever been in and it clearly has enough capital and surplus to meet the needs of the insurance industry today and in the near future."

It took Ralph Nader and the National Insurance Consumers Organization President, Robert Hunter, to "smoke out" the truth about 1985 results.

A gloomy prediction in December of 1985 of a $5 Billion loss in the property/casualty industry was "suddenly" conceded to be a $1.7 Billion net profit after taxes on January 9, 1986 (reported in Washington Post, January 14, 1986, Sari Horwitz).

Best reports:

> "In the first half of 1985, property/casualty stocks in Best's Index have advanced 30%, investor

> excitement being generated by a reasonable consensus that the longest industry down-cycle in history has finally turned, albeit by a small margin, they were rewarded on average by advances twice the size as those reaped by the general stock market."

CONCLUSION

The so-called "crisis" orchestrated and directed by the property/casualty insurance industry is intended to force legislators into curtailing and limiting the rights of consumers to recover damages when they become the victims of wrongful, negligent and culpable conduct of others.

> "It is right for the industry to withdraw and let the pressures for reform build in the courts and in the state legislatures." (Journal of Commerce, "Insurers Told: Exit Some Lines", June 18, 1985). (Insurers' Profits to Zoom", headline U. S. Today, January 14, 1986).

It is obvious to anyone who will look at the evidence and not be influenced by common misconceptions about the legal system, that the recent problems of price and availability are due to "cycles of profit and loss" caused by a desire for market share and over-reliance on investment income to cover business pricing mistakes.

> "I do not believe that there is a tort crisis across the nation. I believe we are witnessing joint action by insurers intended to create an atmosphere where rates can be put too high and legislators will be intimidated into action designed to take away victims' rights and to allow wrongdoers to be unpunished. It was no accident that A. H. Robbins tried to piggyback onto federal tort 'reform' to be excused from its misdeeds." (J. Robert Hunter, President, National Insurance Consumers' Organization, in a speech before the Commissioner's Special Task Force on Property/Casualty Insurance, Eau Claire, Wisconsin, December 18, 1985.

Analysis of the Best data repudiates any consistent relationship between reserving, loss payments, and premium levels to a claimed sudden increase in litigiousness or in an increase in the number and size of claims.

In an authoritative study of litigation in the United States, University of Wisconsin Professor, Marc Gallanter, completely exploded the myth that Americans file more civil lawsuits than citizens of other major industrial countries. A study of Federal Court filings from 1977 through 1983 showed no across-the-board increase in litigiousness. 31 U.C.L.A. L. Review (Oct. 1983), Administrative Office of the United States Courts (1984). See also, The Judges' Journal, Spring 1985, "We're Not a Litigious Society: The Facts Do Not Support the Rhetoric Surrounding the Litigation Explosion," by Stephen Daniels, Ph.D.

Similarly, a Rand Corporation study of jury verdicts in Cook County (Chicago), Illinois, revealed that when inflation is taken into account verdicts today are generally no higher than in 1960.

Two researchers from the Institute for Civil Justice of the Rand Corporation, were quoted in the National Law Journal, November 11, 1985:

> "Our research shows that juries are usually sensible and that their decisions have been remarkably stable over 20 years."

The media reports only the big, sensational awards and lawyers do likewise. Taking advantage of this erroneous perception of "litigiousness", the insurers have unfairly victimized the insurance buyers and turned them on the legal system and lawyers as convenient scapegoats.

Insurance regulation is the answer. Disclosure and accountability is essential. Caps or limits on the recovery of victims will not avoid future arbitrary conduct by the insurers. Isn't it curious that liability insurance was unavailable to governmental units (cities, counties, villages, etc.) in States like Wisconsin, Pennsylvania, and Florida, which have had severe recovery limitations (caps) on personal injury awards in most cases for many years! The question answers itself.

It is time for lawmakers to hold insurance companies accountable for their behavior. No conscientious legislator should accept the propaganda and biased conclusions from the insurance industry without requiring proof. To do so would be irresponsible and unconscionable. It is suggested that legislators consider the following reforms:

1. States should encourage the Federal government to seek a more pro-active role in the regulation of insurance business.

2. State law must require disclosure of loss data on a line-by-line basis which will provide regulators with valid information to discern whether rates are excessive, inadequate, or unfairly discriminatory. Line-by-line reporting will allow for adjustments between personal and commercial lines.

3. Insurance rates must be made based on the most current audited experience data.

4. Insurance regulators need better data-verification techniques, either by conducting their own frequent audits or

using outside auditors. Loss reserves shall be certified annually by an independent certified actuary.

5. Insurers must be required to fully disclose to regulators the total and accurate income earned, through premiums and investments so that valid rate regulation may be implemented.

6. State insurance commissioners and directors must be empowered by the legislatures to regulate, in a meaningful manner, excess, surplus-line carriers and reinsurers, at least to the extent that the Federal government does not so regulate.

7. States need to establish their own reinsurance programs. A citizens' insurance board, modeled after the Citizens' Utility Board, should be established in the states, which would create a citizen group to oversee the insurance industry in the same manner as is done with the utilities.

> "The basic factors leading to this hard market are well known. The soft market spawned a savage price war among insurers trying to increase market share and generate greater premium volume to take advantage of record interest rates." (Source - Mariann Freedman, Best's Review, Property Casualty Edition, February, 1986.)

The insurance crisis is a study in deception. Price gouging and unavailability of insurance was perpetrated by the insurance industry upon the American public and when asked to provide a reason, the industry blamed the civil justice system.

BEST'S AGGREGATES AND AVERAGES - 1985 EDITION - DATA THROUGH 1984

	Assets (1)	Liabilities (2)	Policyholder's Surplus (3)	Net Premiums Written (4)	Loss & LAE Reserves (5)
'67	43,639,000,000	2[illegible],837,000,000	14,802,000,000	23,583,000,000	13,987,000,000
'68	48,084,000,000	31,892,000,000	16,192,000,000	25,766,000,000	15,747,000,000
'69	49,384,000,000	35,400,000,000	13,984,000,000	28,956,000,000	18,027,000,000
'70	55,315,000,000	39,816,000,000	15,499,000,000	32,578,000,000	20,256,000,000
'71	63,206,000,000	44,140,000,000	19,065,000,000	35,380,000,000	22,927,000,000
'72	74,235,000,000	50,423,000,000	23,812,000,000	38,930,000,000	26,609,000,000
'73	77,926,000,000	56,537,000,000	21,389,000,000	42,075,000,000	30,394,000,000
'74	76,976,000,000	60,256,000,000	16,270,000,000	44,704,000,000	34,574,000,000
'75	88,055,000,000	68,343,000,000	19,712,000,000	49,605,000,000	39,513,000,000
'76	105,586,000,000	80,956,000,000	24,631,000,000	60,439,000,000	47,105,000,000
'77	126,613,000,000	97,313,000,000	29,300,000,000	72,406,000,000	56,970,000,000
'78	149,097,000,000	113,718,000,000	35,379,000,000	81,699,000,000	68,767,000,000
'79	173,609,000,000	131,214,000,000	42,395,000,000	90,169,000,000	81,113,000,000
'80	197,678,000,000	145,304,000,000	52,174,000,000	95,702,000,000	92,493,000,000
'81	212,303,000,000	158,498,000,000	53,805,000,000	99,373,000,000	102,422,000,000
'82	231,693,000,000	171,298,000,000	60,395,000,000	104,038,000,000	111,959,000,000
'83	249,121,000,000	183,515,000,000	65,606,000,000	109,247,000,000	122,715,000,000
'84	264,735,000,000	200,925,000,000	63,809,000,000	118,591,000,000	134,926,000,000

BEST'S AGGREGATES AND AVERAGES - 1985 EDITION - DATA THROUGH 1984

	Net Investment Income (6)	UEPR (7)	L & LAE Ratio (8)	Net Premiums Earned (9)	Estimated Loss & LAE Incurred (10)
'67	1,310,000,000	11,832,000,000	0.687		
'68	1,491,000,000	12,529,000,000	0.704	25,069,000,000	17,648,576,000
'69	1,686,000,000	13,618,000,000	0.722	27,867,000,000	20,119,974,000
'70	1,976,000,000	15,294,000,000	0.708	30,902,000,000	21,878,616,000
'71	2,309,000,000	16,435,000,000	0.675	34,219,000,000	23,097,825,000
'72	2,662,000,000	17,777,000,000	0.666	37,588,000,000	25,033,608,000
'73	3,094,000,000	16,944,000,000	0.693	40,908,000,000	28,349,244,000
'74	3,504,000,000	19,881,000,000	0.755	43,767,000,000	33,044,085,000
'75	3,905,000,000	21,529,000,000	0.793	47,957,000,000	38,029,901,000
'76	4,594,000,000	24,850,000,000	0.754	57,118,000,000	43,066,972,000
'77	5,816,000,000	28,387,000,000	0.707	68,869,000,000	48,690,383,000
'78	7,290,000,000	31,375,000,000	0.701	78,711,000,000	55,176,411,000
'79	9,279,000,000	34,585,000,000	0.731	86,959,000,000	63,567,029,000
'80	11,063,000,000	36,446,000,000	0.749	93,841,000,000	70,286,909,000
'81	13,248,000,000	37,816,000,000	0.768	98,003,000,000	75,266,304,000
'82	14,907,000,000	40,126,000,000	0.798	101,728,000,000	81,178,944,000
'83	15,973,000,000	42,450,000,000	0.815	106,923,000,000	87,142,245,000
'84	17,660,000,000	45,332,000,000	0.882	115,209,000,000	101,614,338,000

BEST'S AGGREGATES AND AVERAGES - 1985 EDITION - DATA THROUGH 1984

	Estimated Loss & LAE Paid (11)	Change in Premium Written (12)	Change in Loss & LAE Reserve (13)	Change in Surplus (14)	Change in Loss & LAE Paid (15)
'67					
'68	15,886,576,000	2,183,000,000	1,760,000,000	1,390,000,000	
'69	17,839,974,000	3,190,000,000	2,280,000,000	(2,228,000,000)	1,951,398,000
'70	19,649,616,000	3,622,000,000	2,229,000,000	1,535,000,000	1,809,642,000
'71	20,426,825,000	2,782,000,000	2,671,000,000	3,566,000,000	777,209,000
'72	21,351,608,000	3,570,000,000	3,682,000,000	4,747,000,000	924,783,000
'73	24,564,244,000	3,145,000,000	3,785,000,000	(2,423,000,000)	3,212,636,000
'74	28,864,085,000	2,629,000,000	4,180,000,000	(5,119,000,000)	4,299,841,000
'75	33,090,901,000	4,901,000,000	4,939,000,000	3,442,000,000	4,226,816,000
'76	35,474,972,000	10,834,000,000	7,592,000,000	4,919,000,000	2,384,071,000
'77	38,825,383,000	11,967,000,000	9,865,000,000	4,669,000,000	3,350,411,000
'78	43,379,411,000	9,293,000,000	11,797,000,000	6,079,000,000	4,554,028,000
'79	51,221,029,000	8,470,000,000	12,348,000,000	7,016,000,000	7,841,618,000
'80	58,906,909,000	5,533,000,000	11,380,000,000	9,779,000,000	7,685,880,000
'81	65,337,304,000	3,671,000,000	9,929,000,000	1,631,000,000	6,430,395,000
'82	71,641,944,000	4,665,000,000	9,537,000,000	6,590,000,000	6,304,640,000
'83	76,386,245,000	5,209,000,000	10,756,000,000	5,211,000,000	4,744,301,000
'84	89,403,338,000	9,344,000,000	12,211,000,000	(1,797,000,000)	13,017,093,000

BEST'S AGGREGATES AND AVERAGES - 1985 EDITION - DATA THROUGH 1984

	Net Premium Written plus Investment Income (16)	Net Premium Earned plus Investment Income (17)	Underwriting Gain/Loss (18)
'67	24,883,000,000		(254,000,000)
'68	27,257,000,000	26,560,000,000	(569,000,000)
'69	30,642,000,000	29,553,000,000	(1,048,000,000)
'70	34,554,000,000	32,878,000,000	(426,000,000)
'71	37,669,000,000	36,528,000,000	826,000,000
'72	41,592,000,000	40,250,000,000	1,062,000,000
'73	45,169,000,000	44,002,000,000	6,000,000
'74	48,308,000,000	47,371,000,000	(2,645,000,000)
'75	53,510,000,000	51,862,000,000	(4,227,000,000)
'76	65,033,000,000	61,712,000,000	(2,189,800,000)
'77	78,222,000,000	74,685,000,000	1,112,000,000
'78	88,989,000,000	86,001,000,000	1,296,000,000
9	99,448,000,000	96,238,000,000	(1,301,000,000)
80	106,765,000,000	104,904,000,000	(3,334,000,000)
81	112,621,000,000	111,251,000,000	(6,288,000,000)
82	118,945,000,000	116,635,000,000	(10,290,000,000)
83	125,220,000,000	122,896,000,000	(13,322,000,000)
84	136,251,000,000	132,869,000,000	(21,477,000,000)

Senator **Bumpers**. Mr. Martin, what do you think about Mr. Habush's testimony?

Mr. **Martin**. How much time have I got? [Laughter.]

Senator **Bumpers**. Did you look at the charts and graphs that he had in his——

Mr. **Martin**. No, sir, I have not had time to do that, but I can start to respond.

First, to your initial question to me, did I feel like the illegitimate child at the family picnic—No. 1, I was invited here; No. 2, if I think I feel like the orphan child at the family picnic, yes, I do. I'm between two trial lawyers, formerly highly reputable trial lawyers——

Senator **Bumpers**. Somebody called us vultures this morning. I forget who it was.

Mr. **Martin**. Not I, sir. Not I.

Senator **Bumpers**. Well, I've been called a lot worse names as a Senator than I ever was as a trial lawyer. [Laughter.]

Mr. **Martin**. Senator, this is really a tragic crisis that we're in. The insurance industry has been subject to intense price competition. We are in the commercial lines business; not writing simply class-rated business, we write individual risks and we price them individually. What happened when there were opportunities to earn 21 percent through investment of premiums? This invited a form of competition that we hadn't seen before. It invited companies to come along, engage in cash-flow underwriting, engage in everything possible to have the money coming in so they could invest it.

Now, I must tell you that not all insurers did that, and there were some that did try to stem the tide. One of them did, Aetna Life & Casualty; it got hit two ways, one in the marketplace because it lost market share, and No. 2, it was severely criticized by the NICO organization, National Insurance Consumer Organization, for doing so. And it was attacked in the press by that organization around the country. And yet that, I submit, was responsible conduct on the part of that company at the time.

The Hartford tried to increase its prices at that time, knowing that we were writing business at below cost. And when we did, we lost market share. And so what some of us did was to hunker down and try to live through that terrible period, knowing that at some time it had to end. It did end, finally.

In that period of time, I must tell you, the Hartford Insurance Group lost market share. We didn't grow because we were greedy, as has been suggested by some. That's an unfair charge; it doesn't apply across the board. But in the highly competitive marketing environment, when everybody else is cutting price and you are wholesalers dealing through retailers who have access to lower prices and you don't cut your price, you lose business.

And so management has a very important decision to make. Do you stay in the market? Do you fold your shop? Do you turn loose your people? We have 18,000 employees across the country. Do we start firing them because we no longer have work for them, because we're not going to try to stay in the marketplace? I submit that responsible managements tried to and did stay in the marketplace. Some of those companies which engaged in the most severe of price cutting are no longer with us—Ideal Mutual, a $150 million deficiency company, a company with assets and liabilities with a $150 million deficiency; it's in insolvency proceedings in New York. Union Indemnity, about $138 million. These were companies who were playing pricing games in the marketplace, and they got burned. Maybe they didn't know what they were doing. We knew what they were doing because we lost business to some of those companies, and we lost it time after time when our agents said, can't you do anything for us on price? And we said, we cannot go that low. That's the environment we're in.

With regard to the antitrust laws—because it bears directly on that environment—we are subject to the antitrust laws right now, Senator, with regard to any act of boycott, coercion, or intimidation. It specifically so provides in the McCarran-Ferguson Act. If the Justice Department has any reason to believe that we should be investigated, they will investigate us, we are sure.

We don't talk marketing plans amongst each other. We don't talk pricing amongst each other. But we do——

Senator **BUMPERS**. Let me interrupt you just a moment, Mr. Martin. Has Hartford experienced underwriting losses in the last few years?

Mr. **MARTIN**. Yes, sir, we have.

Senator **BUMPERS**. How much?

Mr. **MARTIN**. The specific numbers—I can bring them out, if I may.

Senator **BUMPERS**. Well, let me ask you——

Mr. **MARTIN**. I can tell you that in 1984, our rate of return on net worth was about 1.2 percent. Now, had it not been for the fact that we were——

Senator **BUMPERS**. You're talking about overall?

Mr. **MARTIN**. Overall, bottom line, after tax, investment income, every damn dime.

Senator **BUMPERS**. Are you including life in that, too?

Mr. **MARTIN**. No, sir—yes, I am. Excuse me. Yes, I am. Because if we take out life insurance, and if we took our gains from life insurance, and if we took out a modest gain from selling a capital asset, we would have had a negative operating return, a significant negative operating return.

Senator **BUMPERS**. Have you got your figures for—are you on a calendar year?

Mr. **MARTIN**. I have calendar year data with me.

Senator, from time to time, we can produce data by line on the policy year; we can produce data by line on an accident year. We have more data—our business is required to submit to the States, which regulate us, more data than any other competitive industry is required to submit to its regulators.

Senator **BUMPERS**. Do you have—can you tell me what the average increase in premiums for all your casualty business is for 1986? How much have you increased premiums, on a percentage basis?

Mr. **MARTIN**. Well, let me cover 1985 to 1986, presently. Across the board, maybe 20 percent. With respect to general liability insurance, we've had roughly a 68-percent increase. Now, some of that——

Senator **Bumpers**. How much will that increase your premiums for liability for 1986?

Mr. **Martin**. Well, I guess there are two ways to look at increasing premiums. I'm going to give you the gross number, and then please recognize that when you look at that in terms of individual pricing, it means something entirely different, simply because as you apply the factors in determining what the price should be for that risk, it may fall under or above that number.

Now, with regard to that 68 percent, not all of it is simply a premium increase. It also includes exposure growth because we provided different coverage for people who have added activities who had to be insured. We have had insurance-to-value increased. We have had other increases with regard to the exposure which go into that number.

With regard to individual risk pricing, there are some risks that have had very substantial increases. Infrequently, 1,000 percent with regard to our primary coverage; more frequently, with regard to excess insurance, and that's insurance over the primary limits we write. To a large extent, the increases in the costs for excess insurance are directly attributable to the increases in costs we experienced in connection with our excess reinsurance markets.

Senator **Bumpers**. How much have you increased your loss reserves for this year?

Mr. **Martin**. I have that. We have increased modestly.

Senator **Bumpers**. A modest increase?

Mr. **Martin** Yes.

Senator **Bumpers**. Why would you increase your loss reserves modestly and your premiums by 68 percent? Does that mean you're not anticipating anything more than a modest increase in your liability——

Mr. **Martin**. We watch our loss reserves very closely. I guess 3 years ago, we had a 17-percent increase. Last year was very modest—I have the exact numbers here and I'll dig them out in just a minute.

No, we're anticipating that right now with regard to the business we're writing, our loss reserves are close to adequate. We have found traditionally at the Hartford—as has the industry—that the industry has under-reserved. Now, there are all kinds of disciplines applying to this system that generate underreserving. For example, corporate managements want to show their stockholders and boards of directors they're doing a good job. And if you under-reserve, it shows a better return. If you under-reserve, your surplus position will be better than it will be if you have to take down surplus in order to add to your reserves. But traditionally, we have been underreserved, possibly as a function of this phenomenon. Possibly because the tort system is so difficult to predict.

Senator **Bumpers**. Do you want the Federal Government—you say here on page 26 that you want the States to encourage the Federal Government to seek a more active role in the regulation of the insurance business? Do you want Congress to start getting into that business?

Mr. **Martin**. No, sir. We're not——

Mr. **Habush**. That's my recommendation.

Senator **Bumpers**. I'm sorry, I'm sorry; that is yours. [Laughter.]

Are you strongly opposed to that? And if so, what are you doing here?

Mr. **Martin**. We were invited.

Senator **Bumpers**. Well, you obviously feel very strongly that the insurance companies have a serious problem. And we are here to determine whether or not the Federal Government has a role in this. And my question to you is, do we or do we not?

Mr. **Martin**. I submit that you don't. I submit that——

Senator **Bumpers**. You'd like us to stay out of it?

Mr. **Martin**. Yes, sir. We are an industry which is capital-intensive. We are subject to the ebbs and flows of worldwide capital markets. We are as much subject to the classical theories of economics as you can imagine; that is, profit opportunities appear, capital flows. We're sensing somewhat of a resurgence into the marketplace now. We're sensing kind of a softening of the hard position that's been taken.

The danger is if the market goes soft again and too much capital comes back, we're going to find ourselves back in the same situation that we were in which companies were giving away coverage at great bargains to the business community.

Senator **Bumpers**. Well, I appreciate your candor on that.

Mr. Habush, I'm going to have to run. I'm going to turn this over to Senator Levin, but let me just ask you one or two quick questions.

Were you here this morning when Mr. Sanders testified as to what the average jury verdict was in this country? He said that in medical malpractice cases, the average jury verdict had gone from $220,000 in 1975 to $1,017,000 in 1985. Product liability recoveries by jury verdict have gone from something like $313,000 to $1.8 million.

Mr. **Habush**. I didn't hear it, Senator, but I've read it over and over again in the last few weeks, and those figures are flawed. We will submit to the committee where they came from. They came from a jury verdict reporting service——

Senator **Bumpers**. That's right. He told me where they came from.

Mr. **Habush**. A reporting service that picks up headlines and typically does not pick up headlines of plaintiff lawsuits with no recoveries. It also is provided information from attorneys——

Senator **Bumpers**. On a voluntary basis?

Mr. **Habush** [continuing]. On a voluntary basis, and my knowledge of attorneys over 25 years is that they tend not to brag about their losses, and they tend not to brag about——

Senator **Bumpers**. Trial lawyers learn early, don't they? Don't tell them about the ones you lost; tell them about the ones you won.

Mr. **Habush**. That's right. So what you have there is a brag sheet, if you will, of the biggest and the best, and hardly the national average. If you averaged in the zeroes—and I think well over 50 percent of the product liability verdicts go for the defense—and the zeroes of medical malpractice where well over 60 or 70 percent go for the defense; and also the $10,000 settlements or verdicts and the $15,000 and the $25,000 and the $30,000, they indicate that the averages would be well under $500,000. Now, that's not chopped liver; I mean, that's still a lot of money, but it's nowhere near the cited statistics that you heard this morning.

Senator BUMPERS. Mr. Habush, one other thing. Let me go back to the question that I addressed erroneously to Mr. Martin, where you say that Congress does have a role in this. Why do you think we do have?

Mr. HABUSH. I have never witnessed an industry that cries out more for regulation than the insurance industry, and I think the admission that you just heard from my colleague to my right—that we can expect this to happen again—ought to scare everyone enough to realize that they are powerless to control their own destiny, and the insurance commissioners in the States are equally powerless to do something about this.

Senator BUMPERS. Why are they?

Mr. HABUSH. Because—for two reasons. First of all, although you can't generalize it in the sense that you can say this about all insurance commissioners, many of them do come from the industry and go back to the industry. You don't hire, as an insurance commissioner, someone who is ignorant of insurance methods and practices. No. 2, the systems have gone to a file-and-use method. That is, you file a rate and you use it and unless a commissioner feels that it's really off the wall or out of sight, they won't step in.

I think that there just has been a manifest lack of control over the rates because if there had been control, Senator, we wouldn't be here talking today. And if there was adequate control in the States, you wouldn't hear the admission we just heard from Mr. Martin a moment ago that we can expect this to happen again, and we'll have hearings here in another 5 years.

Senator BUMPERS. Of course, you can't expect insurance commissioners—like back in the late 1970's—to intervene and say, you're cutting your rates too precipitously? You'd never find an insurance commissioner to do that; and yet, that's one of the reasons the insurance companies say they're in difficult circumstances.

Mr. HABUSH. Yes. I am sorry, Senator; with all respect, I have to quarrel with that expectation. I think if insurance regulators do look into the insurance companies, and if they see that they're underreserving too much in order to pretend that they have profits when they really don't, they can tell them to beef up the reserves because they are falsifying their financial reports. Now, maybe a good company like Hartford doesn't have that happen to them, but a lot of other companies have had that happen to them.

Senator BUMPERS. You're alleging that there's a little accounting legerdemain going on here too, right? Particularly with loss reserves and so on?

Mr. HABUSH. No question about it. If you see—as we've said on page 16 of our statement, in 1984, the insurance industry's own estimate of incurred loss and loss expense payments—which are the reserves—increased by the smallest amount since 1977; yet at the same time, the rate of growth of losses was declining. Premiums—which are price—increased by the largest margin since 1976, over 13 percent.

Now, I'm not an accountant or an actuary, but I have a little trouble with why prices are going up over 13 percent while loss reserves and payments are going down, if in fact, Senator, it's the tort system; because you would expect that prices would be related to expectations of lawsuits and the tort system.

Senator BUMPERS. I have another question, Mr. Martin. Why aren't you people paying any income tax over the last 10 years? Two percent—is that a correct figure?

Mr. MARTIN. I think the number is correct in terms of the premium taxes we pay overall to the States. We pay that whether we make money or we lose money. It's a gross sales tax, which we pay to the States.

In terms of why we don't pay money to the Federal Government, there are at least three reasons. One is, we participate—as do other investors—in something the U.S. Congress has heretofore encouraged. We buy tax-exempt bonds; that gives us income that's not taxable. Two, like other business corporations—oh, I should have added, we also have a benefit which other corporations have of having a tax exemption with regard to a portion of our corporate dividends from unrelated corporations.

In addition, we have had serious operating losses over the years, and many companies have had net operating loss carry-forwards which business corporations are entitled to and which, Lord knows, our business needs perhaps even worse because of the fluctuations in our capital needs.

In addition, we have the ability to tax consolidate with our parents, as other corporations have.

Those are essentially the reasons why our payment of taxes to the U.S. Government is so low.

Senator BUMPERS. Gentlemen, I'm going to turn you over to the tender mercies of Senator Levin of Michigan, and ask him to, at the conclusion of your testimony, adjourn or recess this committee until 9 in the morning.

Mr. Martin, did you want to get some last licks in?

Mr. MARTIN. Yes, I was trying to get some numbers a minute ago, just a small correction. Our loss reserve increase for 1985 was 10.9 percent upward; in 1984, it was 1.4; in 1983, it was 6.1; in 1982, 3.9; and so forth.

Senator BUMPERS. Now, what are those figures?

Mr. MARTIN. Those are our loss reserve increases. We now report our loss development factors to the SEC; we're part of a publicly held corporation, and those numbers are provided to the SEC. We are subject to Federal scrutiny in that sense.

Senator BUMPERS. Gentlemen, thank you very much.

Senator Levin.

Senator LEVIN. Thank you, Senator Bumpers. I'm going to be very brief.

First of all, Mr. Martin, if you could, in order of importance, tell us what factors go into that 68-percent average increase in liability premiums?

Mr. MARTIN. Yes. We look at the manual rates that are applicable to that particular class of risk. We identify the subclass and look at the rate, which is published by the Insurance Services Office, which makes rates on a traditional ratemaking basis.

Incidentally, the Insurance Service Office's rates for, say, general liability insurance—all during that 5-year underwriting cycle——

Senator Levin. Let me interrupt you. What I need is just a simple explanation. I missed the earlier testimony; maybe you've gone into this.

What has caused, in order of their importance, the increases in rates and prices?

Mr. Martin. Rates have gone up, but rates have gone up because of loss experience.

Senator Levin. Now, is it litigation? Is it market conditions? Is it a whole series of other factors which have been enumerated? Lax underwriting standards? Difficulties of obtaining reinsurance?

We're given a whole lot of different reasons for why insurance premiums have gone up. I'm not trying to be technical yet; just——

Mr. Martin. Senator, our data reflects that our costs have gone up because we have losses that are incurred, and we have to put up reserves to pay for them. In terms of what causes the losses, that doesn't get into the ratemaking system.

Senator Levin. Can you identify the causes of the losses in order of their priority and importance?

Mr. Martin. Yes; that's very difficult to do. In my statement today, I indicated the changes in the tort system which we have seen and which we believe are attributable to the increasing costs of liability insurance, commercial liability insurance.

Senator Levin. Is that the only cause of your increased losses, the changes in the tort system?

Mr. Martin. Conceivably not. Conceivably, there are more injuries. But again, none of us really knows what an injury rate is; and again, we don't know to what extent the tort system, in making it easier to file claims, has encouraged more injuries that never went into the tort system to come in. It's very difficult to measure, determine.

Senator Levin. Has there been an effort made to analyze the causes of the losses?

Mr. Martin. You mean—we know, from our claims reports, what was involved with a given claim.

Senator Levin. No. As to whether it's the tort system, whether it's more injuries, whether it's something internal to the insurance industry, whether it's market conditions, whether it's lax underwriting, whatever. Have you analyzed the causes of the increases in your losses?

Mr. Martin. No, sir, not in those terms.

Senator Levin. Can they be analyzed?

Mr. Martin. I suspect it might be done by some outside research organization, but it is not something that is susceptible to determination from the kinds of data we produce.

Senator Levin. OK.

Mr. Habush, just one question for you. You've indicated that you differ with the insurance industry's figures on the average recovery, tort recovery.

Mr. Habush. They're not the insurance industry's figures. They're figures someone picked up from Jury Verdict Research, which was reporting them.

Senator Levin. Oh, excuse me. You've indicated a disagreement with those jury verdict reports?

Mr. Habush. Yes, sir.

Senator **Levin**. And you are going to submit for the record what you indicate are the accurate ones?

Mr. **Habush**. Yes, sir.

[Subsequent information was received and follows:]

ATLA NEWS

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FOR IMMEDIATE RELEASE:

JURY-VERDICT STATISTICS MISUSED, TRIAL LAWYERS ASSERT

(NOTE TO EDITORS AND REPORTERS: Following is a response from the Association of Trial Lawyers of America to the oft-repeated statistics purporting to show that the "average" jury verdicts in products-liability and medical-malpractice cases are unreasonably large. The article demonstrates that the sparse data available are being misused--intentionally or not--by those who seek to alter our civil jury system.)

WASHINGTON, D.C., Dec. 9, 1985 -- Two numbers meant to shock are quoted uncritically by the media with a regularity that approaches the appearance of the Dow-Jones averages. Critics of our civil-justice system misuse the numbers--intentionally or not--to try to show that juries of citizens have gone "crazy" and are making absurd awards. The numbers are being used in an effort to undercut our jury system.

In 1984, the critics of the jury system proclaim, the "average" products-liability award was $1.07 million; the "average" medical-malpractice award, $950,000.

These numbers come from admittedly incomplete statistics of Jury Verdict Research, Inc. (JVR), of Solon, Ohio. There are many things to be said about these statistics, and JVR itself sounds several cautionary notes about them.

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The company points out, for instance, that its summary of verdicts does not include those for the defendants, which contain no awards. JVR adds: "Whenever considering medical-malpractice and products-liability cases, it is important to bear one fact in mind: less than one half of these cases result in a plaintiff verdict when tried by a jury."

Obviously, if the zero-sum verdicts were factored in, the "average," as computed by JVR, would be materially lower than the amounts noted above.

Those who attack our justice system also are quick to cite the JVR numbers on million-dollar verdicts by "juries out of control." In horror, they recite that in 1983 there were 360 verdicts of a million dollars or more, not all, of course, in products-liability and medical malpractice cases. Unreported are these words from JVR: "While an award of one million dollars or more may appear unreasonable at first glance, these are generally made to seriously injured plaintiffs, and the jury's decision to grant such a verdict is usually based upon testimony presenting legitimate computations of the plaintiff's projected lost earnings and the medical expenses necessary to sustain him for life."

Other figures in the files of JVR also go unquoted. The company has a record of 1,642 million-dollar verdicts given individual plaintiffs since 1962. Sixty-nine percent of these awards were made in four injury categories:

--Permanent paralysis (268 awards).

--Permanent brain damage (338).

--Wrongful death (362).

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--Amputations of leg and/or arm, with multiple amputations being common (161).

JVR sums up: "The overwhelming majority of million-dollar verdicts are awarded in cases where the plaintiff has been seriously injured or is completely disabled and may require medical care for life."

And a final caveat from JVR: ". . . it should always be remembered that awards of this magnitude remain unusual and are rarely considered the norm."

A survey by the University of Wisconsin Civil Litigation Research Project also demonstrates that the large case is "a rare phenomenon." A study of 1,600 cases revealed that more than 50 percent dealt with disputes of less than $10,000. Only 12 percent involved claims of more than $50,000. The study further established that more than 90 percent disputes are resolved without litigation and that 90 percent of the cases that are the subject of lawsuits are settled before verdict.

More light on how JVR's statistics are misrepresented is shed by A. Russell Localio, director of research of the Risk Management Foundation in Cambridge, Mass. In an article in the June, 1985, issue of Law, Medicine & Health Care, he addresses specifically the medical-malpractice data, but his analysis is applicable also to JVR's products-liability figures.

The misrepresentations arise, Localio says, from four errors in analysis of JVR statistics. He uses 1982 JVR data.

--The "average" award ($962,258) is improperly defined and mischaracterized. Remember, this figure does not include settlements, which are usually lower than verdicts; it does not take into account reductions in verdicts that often occur in the appellate process; it

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does not include verdicts in which there were no awards to plaintiffs.

--The JVR samples are not random, and they are, therefore, biased. The firm acknowledges that it cannot compile all verdicts. Very likely, it receives notice of the big verdicts but not all the modest ones. This, of course, skews the "average" upward. Localio points out that for 1982 the Insurance Information Institute reported the average plaintiff award for California Superior Court cases as $257,222.

"It is unlikely that the national figure would be 3.75 times that of California, especially if California courts handed down 60 (malpractice) verdicts and JVR reported only 234 nationwide," Localio writes.

(Note: The latest JVR tables show 238 such awards in 1982.)

--There is no adjustment for inflation. To show the true increase in the size of awards from year to year, Localio says, all figures should be expressed, for instance, in 1982 dollars.

--The "average" award is usually construed by the public as the "typical" award, but the JVR "average" is not suitable for such protrayal, because, in this case, the average does not represent the center. An appropriate indicator of the typical verdict "should probably be the median," Localio says, meaning half the awards were above that figure and half below.

JVR's midpoint verdict is $271,000 for products liability and $270,000 for medical malpractice, the incomplete 1984 statistics show.

These numbers are significantly less than the "averages" that those who attack our jury system embrace, but even these suffer the many infirmities cited in this article, and they are perhaps as much handicap as help to objective analysis.

-ATLA-

Commentary

Variations on $962,258: The Misuse of Data on Medical Malpractice

by A. Russell Localio, J.D., M.A., M.P.H., M.S.

Recent years have witnessed discussion among physicians, attorneys, consumers' groups, and insurers on the medical malpractice "crisis" and its dimensions, causes, and cures. As many observers realize, a serious handicap to deliberate and sober analysis lies in the dearth of reliable data on the incidence of iatrogenic injury, the cost of the current system of malpractice litigation, and the trends in claims and costs. Part of this data deficiency lies in the fragmented nature of the insurance system and the absence of central data depositories; part stems from the reluctance of many organizations with data to share legal work product or sensitive information with the public. Because of these data gathering problems, any figures which do appear for the data hungry public elicit much interest.

Jury Verdict Research (JVR), of Solon, Ohio, has been gathering and publishing data annually on jury verdicts. For medical malpractice litigation, JVR publishes figures on the number of verdicts over $1 million, the midpoint (median) verdict, and the "probability range" (interquartile range) representing the middle 50 percent of the verdicts. For 1982, JVR arrived at the following figures: median ($200,000), range ($531 to $29,000,000), interquartile range ($70,000 to $675,000), and average ($962,258).

Probably because of the public's intuitive notion of the average as the measure of a typical value, the press as well as parties testifying before Congress on recently proposed reform legislation has embraced the dramatic figure as worthy of quotation. For example: "Awards in trials now average $962,258." "The mean malpractice settlement in 1982 was $962,258." "Mean of medical malpractice settlements" entitled a bar chart on trends in malpractice, and "growth of average malpractice award" described a similar shaded line chart. In each case the author or speaker was trying to document the alarming growth in malpractice litigation. In each case the statement or graphical display was incorrect and misleading, although very likely the misrepresentations were innocent.

These misstatements arise from four errors in analysis: (1) the failure to define accurately the data being cited, (2) the assumption that an incomplete sample of data represents a random and unbiased sample of all verdicts, (3) the failure to adjust figures to constant dollars and to present graphical displays with this adjustment, and (4) the assumption that the "average" (mean) verdict represents an appropriate summary statistic for a wide ranging distribution of verdicts.

Improper Definition of the Average

In none of the cases cited did the authors characterize properly the figure $962,258. First, the data represent jury verdicts, not settlements. Available evidence suggests that average settlements are substantially lower than average verdicts. Second, the verdicts are not judgments. Not infrequently, jury awards, especially large ones, are reduced by postverdict settlements of the parties, successful defense motions for remittitur (reduction of the jury award) or for new trials, or after an appeal to a higher court. JVR does not purport to represent its data as including these reductions. Third, the authors neglected to consider the many $0.00 verdicts, i.e., those awards of no damages to the plaintiff. Anywhere from 70 percent to 85 percent of all juries rule in favor of the defendant. If an analysis were to consider all zero verdicts, the mathematical average would drop by a factor of 3.5 to 6.

Biased Samples

JVR, by its own admission, attempts but cannot possibly succeed in compiling all verdicts. The reported sample might reflect a representative subset of all verdicts and might have the same average as the population. That result is unlikely, however. More likely, JVR receives notice of all large verdicts and misses some of the more modest awards. The JVR sample might therefore be biased upwards; it might overstate the size of typical verdicts. Readers should not jump to the conclusion that all samples are necessarily fair.

To check the hypothesis of an unbiased sample, the reader can consult other data sources. For 1982, the Insurance Information Institute reported the average plaintiff award for California superior court cases as $257,222. It is unlikely that the national figure would be 3.75 times that of California, especially if California courts handed down 60 verdicts and JVR reported only 234 nationwide.

Constant Dollar Adjustment

Neither of the two graphical displays of trends from 1973 to 1982 was adjusted for inflation. During that period the consumer price index grew from 133.1 to 289.1. If a chart depicts dollars on a vertical scale, it should adjust dollars to a single price level; otherwise, the graph represents a "design variation" and lacks appropriate integrity. To demonstrate the in

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crease in awards, a chart could express all figures in, for example, 1982 dollars. Design variation errors are frequent in data display, although they are usually innocent.

The Average as a Typical Award

The purpose of using the average of a collection of observations is to summarize the location or typical value with as much precision as possible. The average is then a "summary statistic" of the collection of verdicts. By examining an appropriate summary statistic, or a series of these statistics over time, the analyst can determine the trend. Where the collection of verdicts follow a bell-shaped or normal distribution, the average indicates roughly the center of the collection. Where the tails of the distribution are straggling or unsymmetrical, however, the average fails to indicate the center.[10]

For 1982 verdicts, the average may be an unsuitable indicator of the center, because of the clump of verdicts above the $1 million level. Without the raw data, the analyst can only guess about the shape of the distribution of verdicts. The reported interquartile range of $70,000 to $675,000, with the mean falling outside of this range, suggests that the upper tail is long and the average is an unsuitable indicator of the typical verdict.

As to what would be an appropriate typical value, only a thorough analysis of the raw data can reveal. Generally, for a distribution with straggling tails, the median, or middle value, gives a better measure of location than the average.

Conclusion

An appropriate indicator of the typical medical malpractice verdict should probably be the median. In any event, an author should qualify any figure by noting the nature of the observations: a nonrandom sample of verdicts for plaintiffs only. When a reporter wishes to depict trends to support a statement about a growing crisis, he should adjust all years to constant dollars to demonstrate real growth without the effects of inflation. If efforts at reforming methods of compensating patients for medically induced injuries are to succeed, they should be based on the best available data analyzed appropriately. Misleading analysis for partisan purposes will only cloud the issues and hamper progress toward a system of greater equity and efficiency.

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Conference Report—*continued from page 125*

his discussion of quality assurance: "If professionals want to be held less responsible for quality problems, they need to make their practices more directly accountable to patients' desires and other forms of lay judgment."[9] In all of the two days of discussion, perhaps quality and accountability were the two most important concepts to be recognized, and to be preserved in whatever public or private systems prevail.

Such conferences as that hosted by the Urban Institute are useful forums for the exchange of ideas and the airing of new proposals. Participants of more than one conference occasionally complain that they have not learned of new and promising solutions. However, the medical professional liability problem is not one that will be solved by one great speech, or one final conference. What is accomplished in these efforts is a sharpened professional and public appreciation of the issues involved, and an incremental progress toward their resolution.

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Senator Levin. Do you know—are you able to give us any indication as to the increase in the average over time? You said that $500,000 is more accurate now than, I think, the $1.9 million or whatever that particular puffing service was.

Mr. Habush. That's the correct description.

Senator Levin. I think that's the way you described it.

Now, if it's not $1.9 million, if it's $500,000 now, what was it in 1970 relatively? Would it have been a quarter of that $500,000?

Mr. Habush. My response to that is that a Rand Corp., study, conducted in selected counties in the United States, indicated that jury verdicts have not gone up any more when adjusted for inflation. So the verdicts have gone up adjusted for inflation.

Now there has been, clearly——

Senator Levin. Over the last—what, 15 years?

Mr. Habush. Over the last 25 years.

The problem, of course, is that there's a perception of litigiousness and excessiveness in the tort system because the media only reports the big and the successful verdicts. They don't report the unsuccessful ones; they don't report the modest ones. And so a lot of people think that every time somebody goes to a jury, they end up with a *Pennzoil* v. *Texaco* type jury verdict. That isn't the real world, and I think that what was stated earlier, Senator, before you came in, was that in Ontario, the Province of Ontario, where there is a $100,000 limitation on pain and suffering, no contingent fees, virtually no punitive damages, and almost no jury trials, the day care centers, the municipalities, the governmental units, the bus companies, and small businesses are confronted with precisely the same crisis as they have here in the United States; which, it seems to me, kind of repudiates the suggestion that it's the court delivery system which is the cause of this problem.

Senator Levin. I'm just asking my staff if we have a copy of the Rand study. I don't know if other folks have it, but we don't seem to have it.

Mr. Habush. Our staff will be happy to interact with your staff and provide you with all the data that we have and that you need to have.

Senator Levin. Do you want to add something, Mr. Martin?

Mr. Martin. Yes, Senator; we do business in Ontario, and I've talked to our general manager there and the information that we've gotten is that he thinks it's foolish to compare Canada—Ontario—to the United States without recognizing the distinguishing characteristics. For example, insurance costs much less in Canada than it does here to start with. We're talking about commercial general liability insurance.

No. 2, he says that in Canada they're seeing the same kinds of tort explosion through the court system as is occurring here, even though they don't have the jury system. They're also seeing enormous verdicts in cases with very bad injuries.

Senator Levin. Are you familiar with the Rand study?

Mr. Martin. I am not familiar with that particular one. I cannot respond.

Senator Levin. Well, it might be useful if you would not only supply that to us—if you're willing—but also supply that to Mr. Martin so we can get his comments on it.

Mr. **Habush**. I'm sure we would be happy to contribute to the Hartford Insurance Co., our research data that they need to have.

Senator **Levin**. Well, at least at my request. You're not requesting it, but I am.

Mr. **Habush**. Absolutely, Senator.

[Subsequent information was received and follows:]

NOTE: The RAND ICJ study comprises 91 pages; only a handful of pages are excerpted here. However, included is a title page that contains and identifies the Library of Congress catalog information regarding the Report.

ALSO: The statement made by Mr. Habush at an earlier point in his testimony (transcript page 142) that RAND ICJ research has found that "juries are usually sensible and their decisions have been remarkably stable over 20 years" refers to an article written by ICJ researchers and which appears in the National Law Jounal of 11/[illegible]/85, pp. 15-19.

This research is supported by The Institute for Civil Justice.

Library of Congress Cataloging in Publication Data

Shanley, Michael G., 1947-
Comparative justice.

R-3006-ICJ
1. Verdicts--California--San Francisco. 2. Verdicts--Illinois--Cook County. I. Peterson, Mark A., 1946-
II. Title.
KF8990.Z95S53 1983 347.73'77 83-13961
ISBN 0-8330-0512-X 347.30777

The Rand Publications Series: The Report is the principal publication documenting and transmitting the Institute's major research findings and final research results. The Note reports other outputs of Institute research for general distribution. Publications of The Rand Corporation do not necessarily reflect the opinions or policies of Rand's and the Institute's research sponsors

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R-3006-ICJ

Comparative Justice

Civil Jury Verdicts in San Francisco and Cook Counties, 1959-1980

Michael G. Shanley, Mark A. Peterson

1983

35th Year
Rand
SANTA MONICA, CA 90406
THE INSTITUTE FOR CIVIL JUSTICE

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Executive Summary

California courts have a reputation for being generous to persons who bring lawsuits for their injuries and losses. Judges in that state have repeatedly developed legal doctrine extending plaintiffs' rights to recovery, and California juries seem to give big awards. This report examines jury trials in the City and County of San Francisco and compares the outcomes of those trials with jury decisions in Cook County, Illinois (Chicago), another major jurisdiction that we studied previously (Peterson and Priest, 1982). The report also provides initial information about how jury trials in San Francisco were affected by California's change to a comparative negligence rule in 1975.

Changes in the types of cases tried to juries and differences between the two jurisdictions limit the conclusions that we can draw from comparisons until we have conducted further, planned analyses. As a result, this report describes trends in jury trials and verdicts and raises hypotheses about our findings. We have not usually attempted to test the hypotheses suggested in this report, nor have we attempted to explain our findings about trends and differences among types of lawsuits. These subjects are part of our continuing research (see, e.g., Peterson, 1983; Chin and Peterson, 1983). It should also be noted that the relatively small number of cases decided by juries, such as those described in this report, do not necessarily reflect all civil claims; perhaps more than 95 percent of filed lawsuits are either settled or dropped without reaching trial. Although cases tried to juries undoubtedly influence settlements, we cannot be certain that the trends and patterns described here are representative of those for cases that are settled. The Institute for Civil Justice is conducting other research on the relationship between verdicts and settlements. This report examines only the verdicts of civil juries, the most central decisions.

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METHODOLOGY

As with our study in Cook County, we collected data about jury trials from a jury verdict reporter, *Jury Verdicts Weekly*, sold by subscription to lawyers and insurance companies. We obtained detailed information about the parties, their claims, settlement offers and demands, the timing and types of legal actions, and the outcomes of 5,300 trials in the San Francisco County Superior Court and the U.S. District Court for the Northern District of California. These data cover about 85 percent of all jury trials in those courts between 1959 and 1980. Our analyses of Cook County trials were based on 6,000 cases tried in the Law Division of the Cook County Circuit Court and the U.S. District Court for the Northern District of Illinois.[1] The data were coded into computer-readable form by law students working under the direction of one of the authors of the present report and Professor George Priest of the Yale Law School.

The statistical analyses in this report describe aggregate trends for all civil jury trials and for ten separate case types:

- Automobile accidents.
- Common carriers' liability for injuries to passengers.
- Property owners' liability to tenants, guests, and trespassers.
- Street hazard liability for obstructions or negligent design or maintenance of roads or sidewalks.
- Workers' injuries on the job.
- Intentional torts (i.e., assault, discrimination, and false arrest).
- Professional malpractice.
- Product liability.
- Contracts or business torts.
- Miscellaneous actions.

TYPES OF TRIALS

There are far fewer trials in San Francisco courts (usually between 200 to 300 per year) than in Cook County—well under one-half as many. But there were similar trends in recent years toward fewer trials in both jurisdictions. Also, in both jurisdictions there was a growing concentration of trials for several types of cases (malpractice, contracts/business, product liability, intentional tort, worker injury, and miscellaneous) that we identify as high-stakes case types—cases that typically involve greater personal injury or economic losses and result in larger awards (Peterson, 1983). All high-stakes types other than worker injury trials increased in frequency during the 1970s, whereas all low-stakes case types (auto accident, injury on property, common carrier, and street hazard) decreased in number. Sixty percent of all jury trials in San Francisco courts during the 1970s involved high-stakes case types, up from 35 percent in the 1960s. The Cook County trend was similar, but throughout the period a lower proportion of trials in the jurisdiction involved high-stakes case types (from 19 percent in the 1960s to 32 percent in the 1970s).

The types of cases heard by juries in the two jurisdictions have become less similar. During all the years we studied, at least six out of ten jury trials in Cook County involved automobile accidents; by the late 1970s less than 40 percent of jury trials in San Francisco involved auto accidents. Trials of intentional tort—particularly civil rights claims—were the fastest growing portion of the San Francisco caseload. By the late 1970s one in every eight trials involved a claimed intentional tort. Jury trials of intentional torts did not increase appreciably in Cook County; they accounted for between 4 and 5 percent of trials throughout the entire period.

Trials of workplace injury claims were also much more frequent in San Francisco—the second most frequent type of civil case, with 15 percent of trials. In comparison, by the late 1970s worker injury claims were raised in fewer than 7 percent of Cook County trials. Our continuing research is exploring this difference, examining, for example, whether there may be more trials of workplace injuries in San Francisco because California did not frequently adjust workers compensation benefits for inflation.

In both jurisdictions, trials involving contract and business disputes became increasingly important, accounting for 6 percent of all trials in Cook County and 11 percent of all trials in San Francisco during the late 1970s. Such trials were rare during the early 1960s, when they accounted for less than 1 percent of all trials in Cook County and less than 3 percent in San Francisco.

COMPARISON OF JURY VERDICTS

We discovered that despite the special reputation of California's courts, most of our earlier findings about Cook County courts also apply to jury trials in San Francisco:

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[1] This is a sample of one-fourth of all automobile and common carrier trials and 100 percent of all other trials reported by the Cook County *Jury Verdict Reporter*. The comparison does not include cases tried in the Municipal Division of the Cook County Circuit Court, the limited jurisdiction state court, since we had no information for the comparable court in San Francisco.

- In almost half of all trials, plaintiffs win no money (43 percent of trials where liability is contested).
- Most trials involved small or moderate economic stakes: 25 percent of awards in San Francisco are less than $8,000, half are under $21,000.
- After adjusting for inflation, the size of most awards by San Francisco jurors was the same in the late 1970s as in the early 1960s. Awards increased in the early 1970s but then fell in the second half of that decade.
- Few verdicts involve extremely large sums of money, but million dollar awards have become more frequent in both San Francisco and Cook Counties. By the late 1970s almost half of all money awarded by San Francisco juries and 40 percent by Cook County jurors went to the 2 percent of plaintiffs who received million dollar awards.
- The average award doubled in the 1970s in both jurisdictions. But the only reason for this increase in San Francisco was the growing frequency and size of awards near or over $1 million.

Plaintiffs in San Francisco jury trials won more often than those in Cook County—59 percent compared with 52 percent. And San Francisco plaintiffs received larger awards—both the typical (median) and average awards were about 40 percent greater than in Cook County. The median award in San Francisco was $21,000 compared with $15,000 in Cook County; the average was $84,000 compared to $61,000 (all dollar amounts are adjusted for inflation and shown in 1979 dollars).

These differences in trial outcomes might reflect a different mix of cases in the two jurisdictions, i.e., perhaps cases reaching juries in San Francisco involved stronger issues of liability and more serious losses. We found, for example, that a greater proportion of trials in San Francisco involved high-stakes types of cases that often produce large awards. These high-stakes cases more often involved serious injuries and also resulted in larger awards for the same injury (Peterson, 1983).

When we look at each specific type of case, awards were not always greater in San Francisco. In fact awards were larger in Cook County than in San Francisco for three high-stakes case types—10 to 20 percent greater for worker injury and contract and business disputes and over twice as large for product liability cases.

While the greater frequency of high-stakes cases in San Francisco can at least in part explain the larger awards in that jurisdiction, it does not explain why plaintiffs won a larger proportion of cases in San Francisco. In both jurisdictions, plaintiffs' chances of winning varied markedly for different types of cases, ranging from victories in two out of every three worker injury trials to only one of three malpractice trials. But for all types of cases (other than street hazards) plaintiffs in San Francisco won a larger proportion of trials. The difference was the greatest in product liability trials; San Francisco plaintiffs won 54 percent of those trials; Cook County plaintiffs won only 40 percent.

Similarly, California's adoption in 1975 of the comparative negligence rule cannot explain differences in the proportion of trials that plaintiffs won. Plaintiffs won more often in San Francisco than in Cook County both before and after that legal change in California (Illinois adopted comparative negligence in 1981, after the period studied here).

We are continuing to explore why San Francisco plaintiffs fared better in jury trials as we compare how different legal rules, plaintiff losses, liability issues, and the identity of parties influenced jury verdicts in each jurisdiction. At present, we can neither conclude nor rule out the possibility that in similar cases San Francisco juries were more generous to plaintiffs than were Cook County juries.

TRENDS IN LIABILITY

Trends in liability differed between the two jurisdictions. Plaintiffs in Cook County generally fared better in recent years than they had previously—the proportion of plaintiff victories increased for eight types of cases and remained constant for the other three. The trends were mixed in San Francisco. Plaintiffs won an increasing proportion of trials for six types of cases, but changes for two types—automobile accidents and injuries on property—were greatest after 1975, probably reflecting the impact of comparative negligence. On the other hand, San Francisco plaintiffs won a smaller proportion of trials for four other types of cases.

Changes for several specific types of cases were strikingly different between the two jurisdictions. The greatest change in each occurred for contract and business disputes, but the changes were in opposite directions. Cook County plaintiffs improved their proportion of wins by 13 points, from 47 percent in the early 1960s to 60 percent in the late 1970s. In contrast, San Francisco plaintiffs lost 18 points, from 74 percent to 56 percent. Cook County plaintiffs were increasingly successful in product liability trials (from 29 percent to 40 percent), whereas their counterparts in San Francisco became less successful

Senator **Levin**. If you could give us your reaction to it, it would be very helpful.

We will stand in recess until 9. Thanks very much.

[Whereupon, at 1:10 p.m., the committee recessed, to reconvene at 9 a.m. Friday, February 21, 1986.]

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THE COST AND AVAILABILITY OF LIABILITY INSURANCE ON SMALL BUSINESS

FRIDAY, FEBRUARY 21, 1986

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The committee met, pursuant to recess, at 9:03 a.m., in room 428A, Russell Senate Office Building, Hon. Larry Pressler (acting chairman of the committee) presiding.

STATEMENT OF HON. LARRY PRESSLER, A U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA

Senator PRESSLER [acting chairman]. Let us call this hearing to order. If someone would close the door, we will begin.

I want to thank very much the witnesses who have come a distance. I want to, in particular, call forward Michael Nystrom, president of Aerostar International in Sioux Falls; W.D. Gullickson, Jr., general manager and treasurer of the McLaughlin Gormley King Co. of Minneapolis, MN; Danny Coleman, who is the owner of Powers Court and Dubliner Restaurants, Washington, DC; and later we will have Francis Carroll, the president of the Small Business Service Bureau.

First, let me give an overview of what we are doing.

As everybody in this room knows, there has been an immense increase in insurance costs in the past few years. This has resulted in a great increase in the cost of goods to consumers. Whether it is automobile insurance or doctor's insurance or a small businessman's insurance, the cost has gone up, and this has meant that goods and services have become more expensive to the average consumer.

In the international trade markets, we are finding that as much as 20 and 30 percent of some of our products are insurance costs. That means we can't compete internationally because of that.

There has been considerable discussion of who is to blame, who is at fault. We are a society that repays people who have accidents if someone is at fault at a very high level. We are also a very litigious society, a society that has very highly developed rights. We all have our rights, and we can bring a lawsuit. The contingency fee system and lots of other things have resulted in a very costly court system

Also, we have been told that our insurance industry in the late 1970's made some bad investments, and that the cyclical nature of the industry may also be part of the cause of these high rates.

There is a lot of finger-pointing that goes on. In my own case, I have been very critical of the Bar Association and of our civil justice system, but I have also asked some very hard questions in this committee and elsewhere for the insurance industry to justify some of the rates. So, I think we have to take an across-the-board approach

I do not like to see the Federal Government getting involved in new areas of intrusion into areas that traditionally have been reserved for the States. Since the 1945 McCarran-Ferguson Insurance Act, this area has largely been a State matter. But we find that if one State does take steps such as putting caps on punitive damages and has some tort reform, it really doesn't help rates in that State because one State must pay for the sins of the others.

Also, under our court system, you can forum shop. Many of these cases somehow get into New Jersey or California courts where the payments will be higher. Then, once one jury system has set a high recovery for a certain type of tort, the other companies just pay off rather than go through a lawsuit. But the business of forum shopping is an extremely bad practice, in my view.

Last year, Senator Kasten and I had a bill to set uniform product liability codes or levels which would place somewhat of a nationwide standard on these product liability cases. We found that we were defeated in the Commerce Committee by one vote. But there is such an outcry among the people of this country about insurance rates, it has become the consumer issue of the 1980's and 1990's. I would predict that unless something is done, the cost of our products will continue to increase so much as a result of high insurance costs that we will not be able to compete internationally.

Worse still is the fact that some businesses cannot get insurance. For example, recently I held a hearing in western South Dakota, and a day care center told me that they simply could not get insurance, not that it was too high, but they couldn't get it because they didn't have a track record. They were a new business, and in the care of small children there is so much potential liability involved.

So, the point is we have become such a litigious society. We have so many developed rights, and that is very expensive. Beyond that, I think there may be some abuses in the legal system and perhaps in the insurance system. I don't know for certain. That is part of the purpose of this hearing, to try to find out what is going on and what the results are.

Let me also say that I did a survey in my State through a questionnaire that I sent out. We had nearly 600 responses to that questionnaire. Now, granted most people who would respond to a liability insurance survey probably have had problems, so I wouldn't say that this is a scientifically accurate survey. But of those responding to my poll in my State, 32 percent of the respondents indicated their liability insurance had been canceled in the last year. Of that 32 percent, 24 percent have been unable to locate replacement coverage. Those who were able to obtain other coverages contacted an average of three or four companies before finding suitable protection.

Eighty-four percent of the responding businesses had their insurance premiums increase in the last year. 34 percent of those who experienced premium hikes saw increases ranging from 100 to over

500 percent. Fifty-four percent were able to secure the same level of coverage while 21 percent had their coverage reduced. Thirty-one percent found their deductibles had been raised.

Motor carrier coverage was the line of liability insurance in which most businesses experienced difficulties. Twenty-two percent of those responding expressed difficulties in this area. Eighteen percent encountered problems with health care or medical lines. Sixteen percent had difficulty securing adequate or affordable professional liability insurance. Directors and officers (8 percent) governmental insurance (7 percent) were also major sources of hardships.

So, the point is we do have a crisis regarding this matter. I have asked some very hard questions of the insurance companies about their investments and what they are doing, but also I think the legal profession and our legal practices need to be reviewed.

As I mentioned, I hate to see the Federal Government get involved. I would like to see the States do it, but it doesn't seem to be happening. We are faced with the problems of high insurance prices, and we have to solve some of those problems.

I would ask unanimous consent to insert the remainder of my opening statement in the record, and I call on my distinguished colleague from New York, Senator D'Amato.

[The prepared statement of Senator Pressler follows:]

OPENING STATEMENT BY SENATOR LARRY PRESSLER
BEFORE THE
SENATE COMMITTEE ON SMALL BUSINESS
HEARING ON COST AND AVAILABILITY OF LIABILITY INSURANCE
ON SMALL BUSINESS
FEBRUARY 21, 1986

I WANT TO BEGIN BY COMMENDING THE CHAIRMAN OF THIS COMMITTEE, SENATOR WEICKER, FOR CALLING THIS HEARING. VIRTUALLY ANY NEWSPAPER OR PERIODICAL YOU PICK UP THESE DAYS CONTAINS HORROR STORIES ASSOCIATED WITH THE HIGH COST AND SCARCITY OF PROPERTY/CASUALTY LIABILITY INSURANCE. THIS PROBLEM IS BEING EXPERIENCED BY SMALL AND LARGE BUSINESSES, PROFESSIONALS AND GOVERNMENTS. IT IS RAPIDLY BECOMING THE MOST IMPORTANT BUSINESS AND CONSUMER ISSUE OF OUR TIME.

TODAY WE WILL BE ADDRESSING THIS PROBLEM FROM A SMALL BUSINESS PERSPECTIVE. IT IS VITALLY IMPORTANT THAT WE EXMAINE THE EFFECT OF THE INSURANCE PROBLEM FROM THIS PRESPECTIVE BECAUSE SMALL BUSINESSES FORM THE BACKBONE OF OUR ECONOMY. INDUSTRIES DOMINATED BY SMALL BUSINESSES CONTINUE TO ADD JOBS AT A RATE ALMOST TWICE THAT OF INDUSTRIES DOMINATED BY LARGE FIRMS. SMALL BUSINESS IS THE SOURCE OF THE CONTINUED RESURGENCE OF THE AMERICAN ECONOMY. IF THE ISSUE OF ADEQUATE AND AFFORDABLE LIABILITY INSURANCE IS NOT ADDRESSED, THE FUTURE HEALTH OF SMALL BUSINESS AND, THEREFORE, THE FUTURE HEALTH OF OUR ECONOMY IS THREATENED.

INCREASED INSURANCE PRICES WILL RESULT IN HIGHER COSTS OF PRODUCTION, WHICH WILL MEAN FEWER JOBS AND HIGHER PRICES FOR CONSUMERS. HIGHER INSURANCE COSTS WILL ALSO MAKE MAKE IT MORE DIFFICULT TO SELL U.S. PRODUCTS ABROAD.

THE DEPTH OF THIS CRISIS IS BEING EXPLORED IN MANY CONGRESSIONAL COMMITTEES. I RECENTLY CHAIRED HEARINGS OF THIS COMMITTEE IN MY HOME STATE OF SOUTH DAKOTA AND HAVE CHAIRED AND PARTICIPATED IN SENATE COMMERCE COMMITTEE HEARINGS, ALL ON THE ISSUE OF THE HIGH COST AND SCARCITY OF LIABILITY INSURANCE. A NUMBER OF INITIATIVES ARE BEGINNING TO TAKE SHAPE AT THE STATE AND FEDERAL LEVELS. HOWEVER, MUCH REMAINS TO BE DONE.

WE ARE AT A CROSSROADS. WE KNOW FROM THE EXPERIENCE OF BUSINESSES SUCH AS THOSE REPRESENTED HERE TODAY THAT WE ARE CLEARLY IN THE MIDST OF A CRISIS. HOWEVER, THE SOURCE OF THE CRISIS IS NOT AS CLEAR. WE KNOW THAT A PROBLEM EXISTS, BUT WE NEED TO KNOW WHY IT EXISTS!

SOME PEOPLE BLAME THE INSURANCE INDUSTRY AND OTHERS POINT TO OUR LEGAL SYSTEM. I HAVE SPENT MUCH TIME LISTENING TO BOTH SIDES OF THIS DEBATE, AND I MUST SAY THAT I AM EXTREMELY DISAPPOINTED IN WHAT I HAVE, OR MORE IMPORTANTLY, HAVE NOT HEARD THUS FAR. ONCE YOU CUT THROUGH THE RHETORIC, YOU FIND PRECIOUS LITTLE SOLID EVIDENCE ON EITHER SIDE TO SUPPORT THEIR POSITIONS AS TO THE CAUSE OF THE PROBLEM. MEANWHILE, SMALL BUSINESSES, CONSUMERS AND OUR ECONOMY SUFFER.

THE INSURANCE INDUSTRY TENDS TO POINT THE FINGER OF BLAME AT OUR SYSTEM OF TORT LAW. HOWEVER, THE INSURANCE INDUSTRY HAS YET TO PRODUCE ANY SOLID EMPIRICAL EVIDENCE WHICH CONNECTS THE INCREASING COST OF INSURANCE TO THE TORT LAWS OF THE INDIVIDUAL STATES. I DO NOT WISH TO SOUND AS THOUGH I HAVE ANY PREDETERMINED POSITIONS ON THIS ISSUE, BUT IF THE INSURANCE INDUSTRY IS TO CONTINUE URGING TORT REFORM, THEN IT MUST PROVE

THAT A CAUSAL LINK EXISTS. IF TORT LAW IS THE PROBLEM, WHY ARE STATES WITH RELATIVELY CONSERVATIVE TORT LAWS SUFFERING RATE INCREASES OF THE SAME MAGNITUDE AS THOSE WITH MORE LIBERAL TORT LAWS?

ON THE OTHER HAND, ATTORNEYS AND SO-CALLED CONSUMER GROUPS ADVOCATE FEDERAL INVOLVEMENT IN INSURANCE REGULATION. THEY CLAIM THAT THE INSURANCE INDUSTRY IS INVOLVED IN UNFAIR RATE SETTING PRACTICES OR "CONSPIRACIES" DESIGNED TO "BLACKMAIL" STATE LEGISLATURES INTO REFORMING THEIR TORT LAW. UNFORTUNATELY, THE TRIAL LAWYERS AND THESE SO-CALLED CONSUMER GROUPS HAVE OFFERED NO REAL PROOF THAT SUCH A SITUATION EXISTS.

IF ADDITIONAL REGULATION OF THE INSURANCE INDUSTRY IS NEEDED, WE MUST DISCUSS WHAT ROLE, IF ANY, THE FEDERAL GOVERNMENT SHOULD PLAY. THE McCARRAN-FERGUSON ACT OF 1945 DELEGATED TO THE STATES REGULATORY AUTHORITY OVER THE INSURANCE INDUSTRY. IT DID NOT PROVIDE FOR FEDERAL OVERSIGHT OR GUIDANCE. THEREFORE, THE ROLE THAT CONGRESS OR THE FEDERAL GOVERNMENT SHOULD PLAY IN MAKING INSURANCE MORE AFFORDABLE AND AVAILABLE IS UNCLEAR. IT HAS BEEN SUGGESTED THAT WE SHOULD REVISIT McCARRAN-FERGUSON, AND ASSERT A STRONGER FEDERAL ROLE IN INSURANCE REGULATION. MY BASIC PHILOSOPHY HAS ALWAYS BEEN TO LEAVE THESE KINDS OF ISSUES TO THE STATES, BUT THIS PROBLEM SEEMS TO BE TRANSGRESSING STATE BORDERS. IT APPEARS THAT RATES ARE NO LONGER SET ON A STATE-BY-STATE BASIS, AND IT IS UNCLEAR TO ME TO WHAT EXTENT THE INDUSTRY IS REGULATED AT ALL. AS PART OF OUR INQUIRY, WE MUST EXAMINE THE EFFECTIVENESS OF STATE REGULATION.

IN THE PAST YEAR, INSURANCE COMPANY INSOLVENCIES HAVE REACHED

AN HISTORIC LEVEL. THOSE INSOLVENCIES NOT ONLY AFFECT THE AVAILABILITY OF INSURANCE, THEY ALSO PLACE A SEVERE STRAIN ON THE STATE INSURANCE GUARANTY FUNDS WHICH ARE USED TO COVER CLAIMS AGAINST THE INSOLVENT COMPANIES. AS THOSE FUNDS ARE DEPLETED, ADDITIONAL REVENUES MUST BE COLLECTED FROM THE REMAINING COMPANIES, MANY OF WHICH ARE THEMSELVES IN PRECARIOUS FINANCIAL CONDITION. THE CAPITAL EXTRACTED FROM THOSE COMPANIES TO RESTORE THE GUARANTY FUNDS MAY, IN TURN, PUSH THOSE MARGINAL COMPANIES OVER THE FINANCIAL EDGE. THIS ADDITIONAL STRAIN COULD JEAPORDIZE THE ABILITY OF THE GUARANTY FUNDS TO FULFILL THEIR INTENDED PURPOSE, AND THEREBY UNDERMINE ONE OF THE FOUNDATIONS OF THE INSURANCE SYSTEM IN THIS COUNTRY. WHILE THIS DANGEROUS CYCLE HAS NOT YET BEGUN, WE MUST EXAMINE WHAT STEPS THE INSURANCE REGULATORS ARE TAKING TO AVOID THIS POTENTIALLY DISASTROUS SITUATION.

THE PROBLEMS ASSOCIATED WITH THE CURRENT STATE OF THE INSURANCE MARKET ARE CLEAR. YET, WE ARE FAR FROM REACHING ANY KIND OF CONSENSUS ON THE REASONS BEHIND THE CRISIS, OR THE MOST APPROPRIATE SOLUTION TO SOLVE IT. FORMING THAT CONSENSUS IS AN ESSENTIAL FIRST STEP IN THE TASK OF FORMULATING A SOLUTION. WE HOPE THE ADVICE OF THE WITNESSES WHO HAVE JOINED US TODAY WILL HELP US DEVELOP A CLEARER IDEA OF HOW TO PROPERLY ADDRESS THIS COMPLEX ISSUE.

RESULTS OF SENATOR LARRY PRESSLER'S LIABILITY INSURANCE SURVEY OF SOUTH DAKOTA BUSINESSES

In December of 1985, I circulated a questionnaire among the South Dakota business community to gather data which would help me better assess the scope of the liability insurance problem. While the results of this poll are not scientific, they closely track with what I have been told in several hearings and meetings since early December. For this reason, I believe the poll provides a useful overview of the insurance problems faced by South Dakota businesses.

SURVEY FINDINGS:

1) 32 percent of the respondents indicated their liability insurance had been cancelled in the last year.

2) Of that 32 percent, 24 percent have been unable to locate replacement coverage.

3) Those who were able to obtain other coverage contacted an average of three or four companies before finding suitable protection.

4) 84 percent of the responding businesses had their insurance premiums increased in the last year.

5) 54 percent were able to secure the same level of coverage, while 21 percent had their coverage reduced.

6) 31 percent found their deductibles had been raised.

7) Motor carrier coverage was the line of liability insurance in which most businesses experienced problems. 22 percent of those responding expressed difficulties in this area. 18 percent encountered problems with health care or medical lines. 16 percent had difficulty securing adequate or affordable "professional" liability insurance.

STATEMENT OF HON. ALFONSE M. D'AMATO, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator D'AMATO. Mr. Chairman, let me commend you for holding these hearings. We started yesterday. I think what we will hear today is the very poignant testimony from those in the business community, the small businessmen in particular, who find themselves facing a no win situation with escalating costs, costs in many cases that go far beyond their ability to rationally or be able to make a decision to see that they have the coverage necessary. That means that in many cases they are forced to go without coverage at great risk to themselves personally, to their business, to all that they have worked for. In some cases, we have businesses that are forced to close or see certain parts of their operations cease.

So, Mr. Chairman, rather than my continuing to bring forth those incidents that we have heard, I think it would be better that we hear from our panel today. Let me commend you and pledge that I look forward to working with you and the other members of the committee in doing something with this very difficult situation.

[The prepared statement of Senator D'Amato follows:]

STATEMENT BY SENATOR ALFONSE D'AMATO
COMMITTEE ON SMALL BUSINESS
FEBRUARY 21, 1986 9:00AM SR - 428A

MR. CHAIRMAN, AS WE CONTINUE THIS SECOND DAY OF TESTIMONY ON THE COST AND AVAILABILITY OF LIABILITY INSURANCE FOR SMALL BUSINESSES, I WANT TO REITERATE MY CONCERN ABOUT THE INSURANCE CRISIS THAT EXISTS IN THE UNITED STATES.

AS JIM SANDERS, ADMINISTRATOR OF THE SMALL BUSINESS ADMINISTRATION, SUCCINTLY POINTED OUT IN HIS TESTIMONY YESTERDAY, SMALL BUSINESSES PARTICULARLY ARE DISADVANTAGED WHEN LIABILITY INSURANCE BECOMES SCARCE OR OVERLY EXPENSIVE. THE COMPETITIVE ENVIRONMENT IN WHICH THEY EXIST HINDERS THEIR ABILITY TO PASS ON INCREASED PREMIUM COSTS. THIS FORCES THEM TO FOREGO FUTURE EXPANSION AND, INSTEAD, TO REDUCE OPERATING EXPENSES. THIS IS NOT GOOD FOR AMERICA.

THE SMALL BUSINESSMAN IS THE BACKBONE OF MANY NEIGHBORHOODS. HIS ENTREPRENEURIAL SKILLS MUST BE ENCOURAGED, NOT HAMPERED, AS IS THE CASE WHEN HE IS

FORCED OUT OF BUSINESS BECAUSE HE IS NOT ABLE TO OBTAIN THE NECESSARY INSURANCE COVERAGE.

AGAIN, I COMMEND YOU, MR. CHAIRMAN, FOR YOUR ACTIVE INTEREST IN THIS PARTICULAR PROBLEM, AND I LOOK FORWARD TO HEARING FROM OUR DISTINGUISHED WITNESSES.

THANK YOU, MR. CHAIRMAN.

Senator Pressler. We have the distinguished Senator from Illinois, Senator Dixon.

STATEMENT OF HON. ALAN DIXON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator Dixon. Thank you very much, Mr. Chairman.

I am delighted to be here with you this morning and my distinguished friend and colleague from New York. And I have in the audience a friend of mine from my State, Mr. Chairman.

I would like to ask leave to place a statement in the record rather than taking the time of the committee and also to indicate to all of you that a warm friend of mine, the distinguished State Representative from Cook County, State Representative Woods Bowman, is in the audience, and he will be testifying here.

Woods, would you stand up for Senator Pressler and Senator D'Amato to see you? We are delighted to have Representative Bowman with us.

Thank you, Mr. Chairman.

[The prepared statement of Senator Dixon follows:]

STATEMENT BY SENATOR ALAN DIXON

SENATE COMMITTEE ON SMALL BUSINESS

THE COST AND AVAILABILITY OF LIABILITY INSURANCE FOR SMALL BUSINESS

FEBRUARY 21, 1986

MR. CHAIRMAN, DURING YESTERDAY'S HEARING, WE HEARD TESTIMONY FROM REPRESENTATIVES OF THE PARTIES INVOLVED IN THE LIABILITY INSURANCE ISSUE. THE SMALL BUSINESS REPRESENTATIVES PAINFULLY RECOUNTED EXPERIENCING EITHER SIGNIFICANT PREMIUM INCREASES FOR A LESSER AMOUNT OF INSURANCE COVERAGE, OR LOSS OF INSURANCE COVERAGE ALTOGETHER. THESE SITUATIONS HAVE FORCED SMALL BUSINESSES, SOME OF WHICH HAVE NEVER HAD A LIABILITY OR INJURY CLAIM BROUGHT AGAINST THEM, TO "GO BARE", PROVIDE INSURANCE BY ESTABLISHING THEIR OWN MUTUAL INSURANCE COMPANIES, OR CONSIDER GOING OUT OF BUSINESS ALTOGETHER.

YESTERDAY'S WITNESSES IDENTIFIED WHAT THEY VIEWED TO BE CAUSES OF THE LIABILITY INSURANCE DILEMMA. TORT LAW ISSUES, THE INCREASING PROPENSITY OF AMERICAN SOCIETY TO LITIGATE DISPUTES, THE LOSS EXPERIENCE OF THE INSURANCE INDUSTRY, AND NUMEROUS OTHER PROBLEMS HAVE BEEN CITED AS CONTRIBUTING TO THE LIABILITY CRISIS. THE MAGNITUDE OF THIS PROBLEM IS REFLECTED IN A RECENT SURVEY BY THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS IN WHICH 81% OF THE RESPONDENTS FAVORED COMPREHENSIVE REFORM OF THE LEGAL SYSTEM TO REDUCE LITIGATION AND LIMIT THE LIABILITY OF DEFENDENTS IN CIVIL SUITS.

MR. CHAIRMAN, I LOOK FORWARD TO HEARING THE TESTIMONY OF TODAY'S WITNESSES AS WE CONTINUE TO EXPLORE THE LIABILITY INSURANCE AREA.

February 21, 1986

Introductory Remarks for Rep. Woods Bowman and Rep. Alan Grieman

Mr. Chairman, I would like to take this opportunity to introduce two distinguished representatives from the Illinois State Legislature, the honorable Woods Bowman, and the honorable Alan Greiman. Mr. Bowman, who represents the fourth legislative district in Illinois, is scheduled to testify before this committee, and I look forward to his points of view on this important subject. Mr. Greiman, who represents the first legislative district in Illinois, and is the Assistant Majority Leader in the House of Representatives, is a member of the state's Task Force on Liability Insurance.

Both gentlemen are outstanding public servants, and I am sure that the committee will benefit from their testimony.

Senator PRESSLER. Thank you very much.

I would ask witnesses to limit themselves to about 8 minutes, if they could. We are going to put your full statements in the record. If you could summarize, that would be very useful. If you can do it in 5 minutes, that is great, 5 to 8 minutes. Then, we will have more time for questions, but we are going to put your complete statements in the record.

I am going to call first on Mr. Michael Nystrom, president of Aerostar International of Sioux Falls, SD.

STATEMENT OF MICHAEL L. NYSTROM, PRESIDENT, AEROSTAR INTERNATIONAL, INC., SIOUX FALLS, SD

Mr. NYSTROM. Thank you.

I am president of Aerostar International which is a newly formed, wholly owned subsidiary of Raven Industries, a publicly held South Dakota company. Raven's liability insurance problems were one of the primary motivations for forming Aerostar. Aerostar manufactures hot air balloons, the same product line that Raven manufactured for 25 years up until February 1.

This product line is very visible for the company but accounted for less than 10 percent of Raven's total sales. Up until 2 years ago, product liability insurance was available at reasonable prices, but then Raven's problem manifested itself in an insurance premium increase of about 400 percent. Faced with that significant cost of doing business, Raven was forced to pass along the cost to its customers, but most of the cost ended up being borne by the corporation and through lower profit sharing and smaller dividends to the shareholders.

Recently when it came time to renew our product liability insurance, there was a period of time when it seemed that the insurance couldn't even be placed, but in a final effort, we procured the insurance at a rate 2 times that of the previous year, so that in 2 years, our insurance premiums went up 800 percent. Raven was really held ransom to the fact that they wanted to protect their assets which they had built up over 30 years. That, I don't think, is an unreasonable desire.

Now, certainly, the product line cannot hope to cover its own expenses this year. Faced with the uncertain future of insurance availability, Raven took action to limit its long-term liability and established Aerostar. So, Aerostar now becomes responsible for all the balloons or products that we produce and Raven remains responsible for the population of balloons in the field at this time.

Aerostar is a coinsurer on Raven's present policy, but no one knows whether insurance will be available next year or in the years to come. And if it is available, it will probably become even more cost prohibitive.

Aerostar is going to make every effort again to increase its contribution to the moneys needed to pay for the insurance, but the product and the value to its customers is going to allow only so much to be passed on. Whatever is passed on to the customers, buys him absolutely nothing, our products aren't any safer because we pay a high insurance premium. They don't last any longer.

They don't fly any higher or fly more peacefully or give more owners more pleasure. They just cost more.

I think we are like most manufacturers with excessive premiums. We want to build a high quality product that is safe and gives the maximum value to the customer. I think we do that now except it just costs more for the consumer than is necessary. Today, we are not even able to cover the cost of manufacturing the goods, let alone earn a return on our efforts. I don't think this situation was caused by Raven or Aerostar, and we can do little to resolve it.

Certainly one thing that would help us would be a more rational and reasonable way of determining product liability claims. I think if the claims settlements were more predictable, then insurance companies could be expected to set more understandable rates and we could probably work within that system.

However, I think the problem goes beyond litigation and insurance and dollars and cents. At some point, I think people have to become responsible and held accountable for their own actions. A manufacturer should be and be willing to be, but I think also people who misuse our product have to be. No one, I think, has a right to collect money from someone when a problem arises with a product that fails or is used in an improper way or method it was never intended to be.

Yet, today's system seems to promote finding a manufacturer to pay when a problem arises. There are enough lawyers that make significant incomes looking for victims and culprits, and there are others who earn equally large incomes by defending. The deep pocket theory comes into play, and it seems as though the manufacturer with the most insurance or the greatest assets is the most likely to be brought into court no matter what responsibility he plays.

I think the insurance companies have taken the path of least resistance and raised the rates to cover all contingencies, and that leaves manufacturers like us to perform our normal business functions in spite of the handicap and struggle along the best we can.

I don't think the Federal Government can change the attitude of the people, but I do think it can set the rules that we work under. With that in mind, I would hope that this committee would consider strongly and support product liability legislation as it is now before the Commerce Committee.

Thank you.

[The prepared statement of Mr. Nystrom follows:]

Statement of Michael L. Nystrom, President, Aerostar International, Inc., Sioux Falls, SD

My name is Mike Nystrom and I am the President of Aerostar International, Inc., which is a newly formed, wholly owned subsidiary of Raven Industries, a publicly held South Dakota corporation.

Raven's liability insurance problems were one of the primary motivations for forming Aerostar. Aerostar manufactures hot air balloons, the same product line manufactured by Raven for 25 years up until Feb. 1. This product line, though very visible, accounted for less than 10% of Raven's total sales. And up until 2 years ago, product liability insurance had always been available at a reasonable price. But then Raven's problem manifested itself in the form of an insurance premium increase in the neighborhood of 400%. Faced with this significant increased cost of doing business, Raven was forced to pass along some of the cost to its customers but most of the cost was born by the corporation, its employees thru lower profit sharing, and its share holders because of smaller dividends.

Recently when it came time to renew Raven's aviation products liability policy, there was a period of time when it seemed unlikely that the insurance could even by placed. The final effort procured coverage with a premium rate 2 times the rate of the previous year. This means in two years the premium has increased over 800%. Raven was held ransom by its desires to protect and insure its assets which it had built up over 30 years of hard work. This is not an unreasonable desire.

Certainly the product line can not hope to cover its own expenses this year. And faced with an uncertain future, Raven took action to limit its long term liability due to the manufacture of hot air balloons. Aerostar now becomes responsible for its products while Raven remains responsible for the population of balloons already in the field. Aerostar is a co-insurer on Raven's present policy but today no one at Raven is confident insurance will be available, the recent past history would say it will be cost prohibitive, even if it is available.

Certainly, Aerostar will make every effort to increase its contribution toward the money necessary to pay for the insurance. But the product and its value to its customer base will only allow so much to be passed on to the end user. And what ever is passed on to the consumer buys him absolutely nothing. Our products are not safer because we pay high insurance premiums, they do not last longer nor fly more peacefully nor bring more pleasure to their owners. They only cost more.

We are just like most other manufacturers faced with excessive insurance premiums. We want to build a high quality, safe product that gives maximum value to our customer. I think we do that now except that the product costs the consumer more than is necessary and we are now not able to cover our costs for manufacturing the product, let alone earn a return on our efforts.

This situation was not caused by Raven nor Aerostar and we can do little to resolve the problem. One solution would be a more rational and equitable system for determining product liability claims. If claims and settlements were more predictable, insurance rates could be more understandably set and worked with. But to me the problem goes beyond insurance, litigation, and dollars and cents. At some point individuals have to be responsible and held accountable for their own actions. Manufacturers should be, but also should persons who misuse a particular product. No one has an inalienable right to collect money from someone when a problem arises or a product fails to perform in a way it was never intended to perform. Yet today's system promotes finding a manufacturer to pay if a problem arises. It appears that some lawyers make a significant income looking for the victims and the culprits and others earn equally large incomes defending them. Insurance companies take the path of least resistance and raise rates to cover all contingencies and manufacturers like Aerostar struggle to perform the normal business functions in spite of the handicap that the current systems composes.

The federal government cannot change this attitude but it can set the rules that everyone works under. With this in mind, I would urge the members of this committee to support products liability legislation reform and particularly the product liability legislation being considered by the commerce committee.

Senator **Pressler**. Thank you very much.

I shall next call on W.D. Gullickson, Jr., general manager and treasurer of McLaughlin, Gormley, King Co., Minneapolis, MN.

STATEMENT OF WILLIAM GULLICKSON, JR., GENERAL MANAGER/TREASURER, McLAUGHLIN, GORMLEY, KING CO., MINNEAPOLIS, MN

Mr. **Gullickson**. My name is William Gullickson, and I am the general manager of McLaughlin, Gormley, King Co. located in Minneapolis, MN, and also chairman of the Chemical Specialties Manufacturers Association Small Business Council. Mr. Ralph Engel, the president of the Chemical Specialties Manufacturers Association is sitting right behind me in the first row here.

McLaughlin, Gormley, King Co. is not a law firm; we are a chemical manufacturer, a small business engaged primarily in the manufacture and distribution of pesticide technical and intermediate manufacturing use products and a member of the CSMA, which has a membership of over 400 firms. Generally, CSMA represents the consumer side of the chemical industry, including a wide variety of products for the home, industrial, and institutional uses.

While smaller businesses have faced numerous problems during recent years, none are potentially more devastating than that now confronting us with respect to the purchase and continued coverage of liability insurance. CSMA member firms have been faced with skyrocketing premiums and cancellation, even in the instances where no claims have been previously filed. Small companies are being hit broadside unexpectedly with insurance premiums that they cannot pay or with the unappealing realization that they must go bare or simply out of business.

We believe that there are two major problems or reasons for the current insurance crisis. First, the liberal interpretation of the tort laws has resulted in a dilution of the requisites necessary to prove negligence and have resulted in excessive liability awards. Second, fierce competition among insurance companies for investment capital from premiums has resulted in unwise risk management.

The committee should not conclude that our industry or others sat idly by and waited for these unfortunate developments to take place. Quite the contrary, several years ago, CSMA formed an offshore captive insurance facility. The company is called CHEMSPEC Ltd. and it has been in operation since 1978. It has managed to keep the insurance company afloat, but it hasn't been easy for the association.

Recently, the fronting carrier for our company informed us that it would no longer provide fronting services for any captive program. This is typical of what is taking place throughout the insurance industry. Thus, our own insurance company was left without its traditional mechanism for issuing policies and handling claims.

Our recent attempts to remedy this situation are still short of the association's goal. At present, we are writing the insurance direct utilizing CHEMSPEC as an offshore issuing carrier that is admitted in the United States by reason of the formation of a risk retention group in accordance with the Risk Retention Act of 1981.

Recently, the association sent an insurance crisis questionnaire to members in an effort to ascertain the extent of the insurance liability problem. Of the nearly 70 companies which responded to the survey, 55 meet the test for small businesses; that is, less than 500 employees.

More than half of the respondents have been turned down or unable to obtain product liability coverage or have had their coverage reduced in the last year. MGK's coverage was cut in half, and our deductibles were raised from $5,000 to $100,000, and all legal expenses are at our expense.

The survey shows that smaller companies have been hit by reduced or unavailable coverage twice as hard as the larger companies. Reasons cited by insurance carriers for reduction, cancellation, or nonrenewal of policies include no reason given, high risk products, adverse loss experience, insurance capacity problems, and insurance companies generally will not insure the chemical industry.

Small companies do not have the ability to pay the increased insurance premiums, where insurance is available. Some of those premium increases in the chemical specialties area have been as high as 1,000 percent. MGK's premium went from $106,585 to $954,408 in 1 year.

The cost increases generally affected businesses in the following ways: Going bare or without insurance, forced some companies to lay off employees, business expansion plans were curtailed, drastically reduced profitability, self-insurance by a number of firms, or pooling resources with other companies in insurer groups. Our small companies have done much internally over the years to improve risk management and safety precaution techniques within their companies.

The time has come for Congress to act swiftly and diligently. Industry, and particular small businesses, need national uniform product liability standards which preempt the current system of confusing and conflicting State laws. Business firms need to make business decisions based on certainty and predictability.

Efforts by trial lawyers to oppose product liability reform must be met head-on. The Wall Street Journal recently stated that two-thirds of damage awards go to lawyers and one-third to plaintiffs. Surely, there is a better way to equitably compensate those who are legitimately injured while eliminating unnecessary litigation and other legal fees.

CSMA submits that any reform must be equitable to all parties and must adhere to three general principles. First, it must ensure that injured persons will be compensated for injuries from defective or unsafe products. Second, an injured person must be able to receive compensation in a significantly faster timeframe than under the current system. Finally, the new system must be more predictable and consistent than the present tort system.

We also believe that any new proposal should be a combined tort reform and an alternative compensation system similar to those contained in recent Senate Commerce Committee working drafts. A strong tort reform proposal which provides an injured third party the opportunity for full recovery against a manufacturer for negligence is necessary. We believe also, however, that an alternative procedure where an individual may recover limited damages from a separate expedited recovery system should be included as a viable alternative to traditional tort action.

Absent a sound and fair solution to the insurance problem, small business will continue to find it difficult to exist or to compete in the marketplace. The abundant resources, technology, and abilities which the United States still possesses will cease to function, and worthwhile products will disappear because of potential liability problems which are noninsurable.

CSMA urgently requests this committee to carefully examine the insurance problem and our suggested solutions and to put its support behind a bill incorporating the principles which we have discussed here today.

We thank you for this opportunity to testify, and I would be pleased to respond to questions at the appropriate time.

[The prepared statement of Mr. Gullickson follows:]

TESTIMONY OF WILLIAM GULLICKSON, JR.
GENERAL MANAGER
MCLAUGHLIN, GORMLEY, KING COMPANY
BEFORE THE
SENATE SMALL BUSINESS COMMITTEE
FEBRUARY 21, 1986

MY NAME IS WILLIAM GULLICKSON. I AM GENERAL MANAGER OF THE MCLAUGHLIN, GORMLEY, KING COMPANY LOCATED IN MINNEAPOLIS, MINNESOTA, AND, I AM ALSO CHAIRMAN OF THE CHEMICAL SPECIALTIES MANUFACTURERS ASSOCIATION SMALL BUSINESS COUNCIL. MR. RALPH ENGEL, PRESIDENT OF THE CHEMICAL SPECIALTIES MANUFACTURERS ASSOCIATON, INC., (CSMA), IS ACCOMPANYING ME HERE TODAY.

MCLAUGHLIN, GORMLEY, KING COMPANY IS A SMALL BUSINESS ENGAGED IN THE MANUFACTURE AND DISTRIBUTION OF PESTICIDE TECHNICAL AND INTERMEDIATE MANUFACTURING-USE PRODUCTS AND IS A MEMBER OF THE CSMA WHICH HAS A MEMBERSHIP OF OVER 400 FIRMS ENGAGED IN THE MANUFACTURE, FORMULATION, DISTRIBUTION, AND SALE OF NON-AGRICULTURAL PESTICIDES; ANTIMICROBIAL PRODUCTS; DETERGENTS AND CLEANING COMPOUNDS; AUTOMOTIVE SPECIALTY CHEMICALS; AND WAXES, POLISHES AND FLOOR FINISHES.

GENERALLY, CSMA REPRESENTS THE CONSUMER SIDE OF THE CHEMICAL INDUSTRY, INCLUDING A WIDE VARIETY OF PRODUCTS FOR HOME, INDUSTRIAL AND INSTITUTIONAL USES. WE ARE HERE TODAY TO ADVISE THE COMMITTEE OF THE INSURMOUNTABLE PROBLEMS CONFRONTING SMALL BUSINESSES WITH RESPECT TO OBTAINING PRODUCT LIABILITY INSURANCE, TO OFFER OUR VIEWS AS TO THE REASONS FOR THESE PROBLEMS AND TO PROPOSE CONSTRUCTIVE SUGGESTIONS TO THE COMMITTEE WHICH WE BELIEVE WILL LESSEN THE BURDENS ON SMALLER FIRMS.

I. DISCUSSION OF PROBLEMS CONFRONTING SMALL BUSINESSES

WHILE SMALLER BUSINESSES HAVE FACED NUMEROUS PROBLEMS DURING RECENT YEARS, NONE ARE POTENTIALLY MORE DEVASTATING THAN THAT NOW CONFRONTING US WITH RESPECT TO THE PURCHASE AND CONTINUED COVERAGE OF LIABILITY INSURANCE. CSMA MEMBER FIRMS HAVE BEEN FACED WITH SKYROCKETING PREMIUMS AND CANCELLATION, EVEN IN INSTANCES WHERE NO CLAIMS HAVE PREVIOUSLY BEEN FILED. SMALL COMPANIES ARE BEING HIT BROADSIDE UNEXPECTEDLY WITH INSURANCE PREMIUMS THAT THEY CANNOT PAY OR WITH THE UNAPPEALING REALIZATION THAT THEY MUST GO BARE OR SIMPLY GO OUT OF BUSINESS. WHILE U.S. CITIZENS CRY OUT TO OUR GOVERNMENT THAT WE ARE LOSING JOBS TO FOREIGN COMPETITION, THAT OUR TRADE DEFICITS ARE INCREASING, AND THAT OUR FIRMS CANNOT COMPETE IN THE MARKETPLACE BECAUSE OF THE BURDENS IMPOSED UPON THEM, WE HAVE PUT UP WITH AN INSURANCE SYSTEM SUBJECT TO VARYING STATE REQUIREMENTS AND A LEGAL SYSTEM WHICH ENCOURAGES LITIGATION. AS A RESULT SMALL BUSINESS IS SUFFERING A TERRIBLE DRAIN UPON ITS INDUSTRIAL RESOURCES WHICH MUST BE RECTIFIED.

II. OUR INSURANCE DILEMMA AND HOW WE GOT THERE

WE BELIEVE THAT THERE ARE TWO MAJOR REASONS FOR THE CURRENT INSURANCE CRISIS. FIRST, LIBERAL COURT INTERPRETATION OF THE TORT LAWS HAVE RESULTED IN A DILUTION OF THE REQUISITES NECESSARY TO PROVE NEGLIGENCE AND HAVE RESULTED IN EXCESSIVE LIABILITY AWARDS; AND SECOND, FIERCE COMPETITION AMONG INSURANCE COMPANIES FOR INVESTMENT CAPITAL FROM PREMIUMS HAS RESULTED IN UNWISE RISK MANAGEMENT.

OVER THE YEARS THE JUDICIAL SYSTEM HAS ERODED AND EXPANDED THE TRADITIONAL ELEMENTS NECESSARY FOR A PLAINTIFF TO PREVAIL ON A CLAIM OF NEGLIGENCE TO THE POINT WHERE LITIGATION IS ENCOURAGED. THIS LITIGIOUS POSTURE ADDS NOTHING TO OUR GROSS NATIONAL PRODUCT AND, IN FACT, IS A MAJOR CAUSE OF OUR INABILITY TO COMPETE, TO DEVELOP AND TO MARKET NEW PRODUCTS. BROADENED THEORIES OF STRICT LIABILITY HAVE HELD FIRMS AND THEIR INSURERS LIABLE EVEN WHERE FAULT CANNOT BE SHOWN, AND, JUDGES AND JURIES HAVE REWARDED PREVAILING PLAINTIFFS WITH UNREASONABLY GENEROUS JUDGMENTS. IF ONE ADDS TO THIS FACTOR THE FINANCIAL DRAIN BROUGHT ABOUT BY LEGAL DEFENSE FEES (IN 1983 COMMERCIAL GENERAL LIABILITY WAS 2.9 BILLION DOLLARS OR APPROXIMATELY 25 CENTS OF EVERY PREMIUM DOLLAR FOR DEFENDING SUITS) THEN IT IS EASY TO UNDERSTAND WHY OUR SHIP IS SINKING.

THE SECOND REASON FOR THE CURRENT LIABILITY CRISIS IS THE UNWISE MANAGEMENT OF RISKS BY INSURANCE COMPANIES. FANNED BY FIERCE PRICE COMPETITION IN THE LATE 1970'S AND EARLY 80'S, INSURANCE FIRMS MARKETED POLICIES IMPRUDENTLY AND PRACTICED PREMIUM PRICE CUTTING. THE GOAL OF THE INDUSTRY WAS TO INVEST PREMIUMS AT THE HIGH INTEREST RATES WHICH THEN PREVAILED. HOWEVER, WHEN INTEREST RATES FELL DRAMATICALLY IN 1984, THE INSURANCE INDUSTRY WAS FACED WITH INSUFFICIENT INCOME TO COVER THE CLAIMS FROM POLICIES WHICH IT HAD UNDERWRITTEN. PROPERTY AND CASUALTY INSURERS HAD 21 BILLION DOLLARS IN NET LOSSES IN 1984 ALONE.

III. INDUSTRY ATTEMPS TO INSURE ITSELF

THE COMMITTEE SHOULD NOT CONCLUDE THAT OUR INDUSTRY OR OTHERS SAT AROUND IDLY AND WAITED FOR THESE UNFORTUNATE DEVELOPMENTS TO TAKE PLACE. QUITE THE CONTRARY, SEVERAL YEARS AGO CSMA, FORMED AN OFFSHORE CAPTIVE INSURANCE FACILITY. OUR COMPANY IS CALLED CHEM-SPEC INSURANCE LTD. AND HAS BEEN OPERATIONAL SINCE 1978. WE HAVE MANAGED TO KEEP OUR OWN INSURANCE COMPANY AFLOAT, BUT MAKE NO MISTAKE, THE SEAS HAVE BEEN ROUGH.

RECENTLY, THE FRONTING CARRIER FOR OUR COMPANY INFORMED US THAT IT WOULD NO LONGER PROVIDE FRONTING SERVICES FOR ANY CAPTIVE PROGRAM. THIS IS TYPICAL OF WHAT IS TAKING PLACE THROUGHOUT THE INSURANCE INDUSTRY. THUS, OUR OWN INSURANCE COMPANY WAS LEFT WITHOUT ITS TRADITIONAL MECHANISM FOR ISSUING POLICIES AND HANDLING CLAIMS. OUR RECENT ATTEMPTS TO REMEDY THIS SITUATION ARE STILL SHORT OF OUR GOAL. AT PRESENT, WE ARE WRITING THE INSURANCE DIRECT, UTILIZING CHEM-SPEC AS AN OFFSHORE ISSUING CARRIER THAT IS ADMITTED IN THE UNITED STATES BY REASON OF THE FORMATION OF A RISK RETENTION GROUP IN ACCORDANCE WITH THE RISK RETENTION ACT OF 1981.

AT PRESENT WE ARE ISSUING PRIMARY INSURANCE ONLY AT THE $150,000 LEVEL, TRULY A MINIMUM AMOUNT. WE ARE CURRENTLY NEGOTIATING WITH SEVERAL REINSURANCE COMPANIES TO PROVIDE EXCESS COVERAGE AT TWO LEVELS - $350,000 EXCESS OF $150,000 AND $500,000 EXCESS OF $500,000. THIS WOULD PROVIDE COMPANIES WITH $1,000,000 COMBINED SINGLE LIMIT OF COVERAGE AND ALLOW FOR UMBRELLA COVERAGE WHEN AVAILABLE.

BECAUSE WE FIND OURSELVES STILL SOMEWHAT IN UNCHARTERED WATERS, A DECISION WAS MADE NOT TO TAKE ON ANY NEW INSUREDS WHILE THESE NEGOTIATIONS ARE STILL ONGOING.

IV. CSMA'S INSURANCE CRISIS QUESTIONNAIRE

RECENTLY, CSMA SENT AN INSURANCE CRISIS QUESTIONNAIRE TO MEMBERS IN AN EFFORT TO ASCERTAIN THE EXTENT OF THE INSURANCE LIABILITY PROBLEM. THE ASSOCIATION ASKED THIRTEEN REVEALING QUESTIONS, AS TO THE TYPE OF INSURANCE COVERAGE WHICH FIRMS REQUIRE TO OPERATE AND THE DIFFICULTY IN OBTAINING INSURANCE COVERAGE. IT ASKED FOR REASONS GIVEN BY INSURANCE CARRIERS FOR REDUCTION, CANCELLATION OR NON-RENEWAL OF POLICIES AS WELL AS FOR THE INCREASED COSTS OF INSURANCE COVERAGE, IF IN FACT COVERAGE WAS AVAILABLE. A COPY OF THE QUESTIONNAIRE IS ATTACHED TO THIS TESTIMONY FOR YOUR INFORMATION.

NEARLY 70 COMPANIES RESPONDED TO THE SURVEY AND THE RESULTS ARE REPRESENTATIVE OF THE PROBLEMS CONFRONTING SMALL BUSINESSES IN OBTAINING LIABILITY INSURANCE. SPECIFICALLY THE HIGHLIGHTS AS SHOWN BY THIS SURVEY ARE AS FOLLOWS:

A. CSMA RECEIVED SOME 70 RESPONSES TO THE SURVEY THUS FAR. THIS REPRESENTS NEARLY 20% OF CSMA MEMBERS. 55 MEET THE TEST FOR SMALL BUSINESS (UNDER 500 EMPLOYEES).

B. MORE THAN HALF OF THE RESPONDENTS HAVE BEEN UNABLE TO OBTAIN PRODUCTS LIABILITY COVERAGE OR HAVE HAD THEIR COVERAGE REDUCED IN THE LAST YEAR.

C. 25% OF LARGE COMPANIES HAVE BEEN UNABLE TO OBTAIN PRODUCTS LIABILITY COVERAGE OR HAVE HAD THESE COVERAGES REDUCED IN THE LAST YEAR.

D. THE SURVEY SHOWS THAT SMALLER COMPANIES HAVE BEEN HIT BY REDUCED OR UNAVAILABLE COVERAGE TWICE AS HARD AS THE LARGER COMPANIES. REASONS FOR THIS, OF COURSE, ARE THE ABILITY OF LARGER COMPANIES TO SELF-INSURE OR RETAIN A LARGER PORTION OF THE RISK AS WELL AS A BETTER ABILITY TO PAY SIGNIFICANTLY INCREASED PREMIUMS.

E. REASONS CITED BY INSURANCE CARRIERS FOR REDUCTION, CANCELLATION OR NON-RENEWAL OF POLICIES INCLUDE: (OVERALL)

1. NO REASON GIVEN - 30 OVERALL/26 SMALL BUSINESSES
2. HIGH RISK PRODUCTS - 20 OVERALL/16 SMALL BUSINESSES
3. ADVERSE LOSS EXPERIENCE - 3 (ALL SMALL BUSINESSES)
4. INSURANCE CAPACITY PROBLEMS - 14 OVERALL (7 EACH)
5. INSURANCE INDUSTRY GENERALLY WILL NOT INSURE CHEMICAL INDUSTRY - 11 (10 SMALL)
6. ONLY TWO COMPANIES (BOTH LARGE BUSINESSES) REPORTED BAD LOSS HISTORY AS THE REASON FOR REDUCTION OR CANCELLATION OF INSURANCE.

F. MOST OF THE SMALLER COMPANIES DO NOT REQUIRE ENVIRONMENTAL IMPAIRMENT LIABILITY COVERAGE. AS CAN BE EXPECTED, THE LARGER COMPANIES REQUIRE FROM $1-200 MILLION IN COVERAGE FOR SUDDEN/ACCIDENTAL POLLUTION AS WELL AS $1-10 MILLION FOR GRADUAL POLLUTION. BOTH TYPES EIL INSURANCE ARE VIRTUALLY UNOBTAINABLE IN THE MARKETPLACE. THIS FACT IS BORNE OUT BY OUR SURVEY.

G. SMALL BUSINESSES REQUIRE FROM $500,000 - $10 MILLION IN VENDORS COVERAGE. THIRTY PERCENT OF SMALL BUSINESSES RESPONDING REQUIRE NONE. MANY CUSTOMERS REQUIRE THIS ADDITIONAL PROTECTION COVERAGE UP TO SPECIFIED LIMITS (USUALLY $1 MILLION) TO DO BUSINESS WITH THE SUPPLIER. IF THIS COVERAGE IS UNOBTAINABLE OR

TOO COSTLY FOR THE SMALL BUSINESS TO PURCHASE, THE LIKELIHOOD OF LOSING CUSTOMERS IS CERTAIN.

H. TWO-THIRDS OF ALL RESPONDENTS INDICATE THEY HAVE EITHER BEEN TURNED DOWN BY THEIR INSURANCE CARRIER OR HAD THEIR COVERAGE REDUCED IN THIS AREA FROM YEARS PRIOR TO 1985.

I. LARGER MEMBERS REQUIRE $1 MILLION +. OUR SURVEY SHOWS THREE OUT OF EIGHT HAVE EITHER BEEN TURNED DOWN OR HAD THEIR COVERAGE REDUCED. OUR SURVEY SHOWS THE SAME RESULTS FOR BOTH LARGE AND SMALL COMPANIES IN THIS AREA.

J. SMALL COMPANIES DO NOT HAVE THE ABILITY TO PAY THE INCREASED INSURANCE PREMIUMS -- SOME AS HIGH AS 1,000%.

PERCENTAGE OF SMALL BUSINESS PREMIUM INCREASES AS FOLLOWS:

46-60% INCREASE IN PREMIUM - 5% OF RESPONDENTS
100% INCREASE IN PREMIUM - 25% OF RESPONDENTS
250% INCREASE IN PREMIUM - 25% OF RESPONDENTS
500% INCREASE IN PREMIUM - 19% OF RESPONDENTS
750% INCREASE IN PREMIUM - 5% OF RESPONDENTS
1,000% INCREASE IN PREMIUM - 4% OF RESPONDENTS

K. LARGE COMPANIES ARE RUNNING PARALLEL WITH SMALLER COMPANIES IN PREMIUM INCREASES.

M. FOR A FEW COMPANIES THE COST INCREASE HAS HAD LITTLE IMPACT ON THEIR BUSINESS (11 OUT OF 67 COMPANIES OVERALL). FOR THE REST, COST INCREASES HAVE AFFECTED BUSINESSES IN THE FOLLOWING WAYS:

1. GOING "BARE" OR WITHOUT INSURANCE - 22 OVERALL/ 18 SMALL BUSINESSES;
2. LAYOFFS - 2 SMALL BUSINESSES OUT OF 67 OVERALL;
3. BUSINESS EXPANSION PLANS CURTAILED - 35 SMALL BUSINESSES;
4. DRASTICALLY REDUCED PROFITABIITY - 39 OVERALL/ 35 SMALL BUSINESSES;
5. SELF-INSURANCE - 23 OVERALL/14 SMALL BUSINESSES;

6. POOLING RESOURCES WITH OTHER COMPANIES IN INSURE GROUP - 10/9 SMALL BUSINESSES.

M. OUR SMALL COMPANIES HAVE DONE MUCH INTERNALLY TO IMPROVE RISK MANAGEMENT AND SAFETY PRECAUTIONS TECHNIQUES WITHIN THEIR COMPANY. THESE INCLUDE CAPITAL IMPROVEMENTS (19); EMPLOYEE SAFETY TRAINING PROGRAMS (41); ROUTINE SAFETY INFORMATION UPDATED AND DISSEMINATED TO EMPLOYEES (41); AUDITING FOR COMPLIANCE WITH SAFETY REGULATIONS (35); ENVIRONMENTAL AUDITING (17); HAZARD COMMUNICATION; PACKAGING IMPROVEMENTS; CUSTOMER EDUCATION.

V. SUGGESTIONS FOR THE COMMITTEE TO LESSEN THE INSURANCE BURDEN ON SMALL BUSINESSES

THERE CAN BE NO QUESTION THAT A SERIOUS PROBLEM EXISTS WITH RESPECT TO THE ABILITY OF SMALL BUSINESSES TO PURCHASE AND TO PAY RATIONAL PREMIUMS FOR LIABILITY COVERAGE. THERE IS MUCH CONCERN OVER THE FAILURE OF THE INSURANCE INDUSTRY TO PREVENT THIS CRISIS FROM ESCALATING.

THE TIME HAS COME FOR CONGRESS TO ACT SWIFTLY AND DILIGENTLY. INDUSTRY, AND PARTICULARLY SMALL BUSINESSES, NEED NATIONAL UNIFORM PRODUCT LIABILITY STANDARDS WHICH PREEMPT THE CURRENT SYSTEM OF CONFUSING AND CONFLICTING STATE LAWS. BUSINESS FIRMS NEED TO MAKE BUSINESS DECISIONS BASED ON CERTAINTY AND PREDICTABILITY. CONGRESS MUST FACE THE ISSUE AND CONSIDER PROPOSALS FOR ALTERNATIVE COMPENSATION SYSTEMS IN CONJUNCTION WITH PRODUCT LIABILITY REFORMS.

EFFORTS BY TRIAL LAWYERS TO OPPOSE PRODUCT LIABILITY REFORM MUST BE MET HEAD-ON. THE WALL STREET JOURNAL RECENTLY STATED THAT TWO-THIRDS OF THE DAMAGE AWARDS GO TO LAWYERS AND

ONLY ONE-THIRD TO PLAINTIFFS. SURELY THERE IS A BETTER WAY TO EQUITABLY COMPENSATE THOSE WHO ARE LEGITIMATELY INJURED WHILE ELIMINATING UNNECESSARY LITIGATION AND LEGAL FEES. CONSUMER GROUPS AND LABOR UNIONS WHICH HAVE OPPOSED EFFORTS TO ENACT NATIONAL UNIFORM PRODUCT LIABILITY STANDARDS SHOULD BE URGED TO JOIN IN A REVISION OF THE LAWS THAT RESULT IN THE FAIR TREATMENT FOR INJURIES AND ENHANCE THE GOAL OF KEEPING BUSINESS IN THE UNITED STATES VIABLE AND ACTIVE, THEREBY SECURING JOBS AND REVITALIZING OUR NATIONAL BUSINESS SYSTEM. THE LEGAL PROFESSION ITSELF SHOULD REEXAMINE ITS CANNONS OF ETHICS AND HEED ITS MANDATES THAT PRECIPITOUS AND UNFOUNDED LITIGATION SHOULD NOT BE SANCTIONED NOR ENCOURAGED.

CSMA SUBMITS THAT ANY REFORM MUST BE EQUITABLE TO ALL PARTIES AND MUST ADHERE TO THREE GENERAL PRINCIPLES. FIRST, IT MUST INSURE THAT INJURED PERSONS WILL BE COMPENSATED FOR INJURIES FROM DEFECTIVE OR UNSAFE PRODUCTS. SECOND, AN INJURED PEPSON MUST BE ABLE TO RECEIVE COMPENSATION IN A SIGNIFICANTLY FASTER TIME FRAME THAN UNDER THE CURRENT SYSTEM. FINALLY, THE NEW SYSTEM MUST BE MORE PREDICTABLE AND CONSISTENT THAN THE PRESENT TORT SYSTEM.

WE ALSO BELIEVE THAT ANY NEW PROPOSAL SHOULD BE A COMBINED TORT REFORM AND AN ALTERNATIVE COMPENSATION SYSTEM SIMILAR TO THOSE CONTAINED IN RECENT SENATE COMMERCE COMMITTEE WORKING DRAFTS. A STRONG TORT REFORM PROPOSAL WHICH PROVIDES AN INJURED THIRD PARTY THE OPPORTUNITY FOR FULL RECOVERY AGAINST A MANUFACTURER FOR NEGLIGENCE IS NECESSARY. WE BELIEVE ALSO, HOWEVER, THAT AN ALTERNATIVE PROCEDURE WHERE AN INDIVIDUAL MAY

RECOVER LIMITED DAMAGES FROM A SEPARATE EXPEDITED RECOVERY SYSTEM SHOULD BE INCLUDED AS A VIABLE ALTERNATIVE TO THE TRADITIONAL TORT ACTION. SUCH A SYSTEM WOULD BE BENEFICIAL TO BOTH INJURED PERSONS AND TO BUSINESSES, AND WOULD CERTAINLY ELIMINATE UNNECESSARY AND UNWANTED LEGAL EXPENSES.

THE ALTERNATE LIMITED DAMAGES PROCEDURE SHOULD REQUIRE A LOWER BURDEN OF PROOF FOR MANUFACTURE WRONG DOING; BUT RECOVERY WOULD BE LIMITED TO THE NET ECONOMIC LOSS. RECOVERY FOR PAIN AND SUFFERING AND FOR PUNITIVE DAMAGE WOULD ONLY BE AVAILABLE UNDER THE TRADITIONAL NEGLIGENCE BASED TORT SYSTEM. INDIVIDUALS WOULD HAVE TO MAKE A CHOICE BETWEEN THE TORT SYSTEM AND THE EXPEDITED CLAIMS PROCEDURE. THIS TYPE OF SYSTEM WOULD PROVIDE THE CLAIMANT WITH A FASTER MEANS OF RECOVERY WITH A MINIMAL COST. IF THE CLAIMANT CHOOSES THE TORT PROCEDURE, THE PROCESS, UNDERSTANDABLY, WOULD TAKE LONGER AND WOULD BE MORE EXPENSIVE; BUT, THE CLAIMANT COULD RECOVER FOR PAIN AND SUFFERING AND PUNITIVE DAMAGES FOR PRODUCTS CLEARLY DEFECTIVE OR FOR NEGLIGENCE ON THE PART OF A MANUFACTURER. SUCH EXPEDITED CLAIMS PROCEDURE COULD ASSURE THE FUTURE STABILITY OF THE TORT SYSTEM, WHILE AT THE SAME TIME CUTTING DOWN ON THE COSTS, PARTICULARLY LEGAL FEES INVOLVED.

OF SIGNIFICANT IMPORTANCE IN THE REVISION PROCESS IS CLEAR STATUTORY LANGUAGE ESTABLISHING STANDARDS OF WRONG DOING OR RESPONSIBILITY FOR RECOVERY UNDER THE EXPEDITED CLAIMS PROCEDURE. SUCH BURDEN OF PROOF SHOULD BE LOWER THAN THE NEGLIGENCE STANDARD WHICH WOULD BE MAINTAINED IN THE TORT SYSTEM. IN ARRIVING AT THE APPROPRIATE LANGUAGE, LEGISLATORS SHOULD MAKE SURE THAT SUCH A STANDARD IS ACHIEVABLE SO THAT CLAIMANTS ARE ENCOURAGED TO USE THE EXPEDITED CLAIMS PROCEDURE, BUT TOUGH ENOUGH TO PREVENT

FRAUDULENT OR UNREASONABLE CLAIMS FROM BEING FILED.

VI. CONCLUSION

ABSENT A SOUND AND FAIR SOLUTION TO THE INSURANCE PROBLEM, SMALL BUSINESS WILL CONTINUE TO FIND IT DIFFICULT TO EXIST OR TO COMPETE IN THE MARKETPLACE. THE ABUNDANT RESOURCES, TECHNOLOGY, AND ABILITIES WHICH THE UNITED STATES STILL POSSESSES WILL CEASE TO FUNCTION AND WORTHWHILE PRODUCTS WILL DISAPPEAR BECAUSE OF POTENTIAL LIABILITY PROBLEMS WHICH ARE NON-INSURABLE. A RECENT EXAMPLE OF THIS IS THE WITHDRAWAL BY G.D. SEARLE OF ITS INTRAUTERINE BIRTH-CONTROL DEVICE FROM THE MARKET BECAUSE THE COST OF DEFENDING THE PRODUCT HAS BECOME PROHIBITIVE, EVEN THOUGH THE COMPANY HAS PREVAILED IN JUST ABOUT ALL THE SUITS BROUGHT AGAINST IT. THE WITHDRAWAL OF THIS PRODUCT IS ILLUSTRATIVE OF THE PROBLEMS FACING EVEN SMALL BUSINESSES TODAY. PRODUCTS SUCH AS SEARLE'S DEVICE WHICH ARE RECOGNIZED AS BEING SAFE AND EFFECTIVE ARE BEING WITHDRAWN OR NOT MARKETED BECAUSE OF THE POTENTIAL FOR LIABILITY CLAIMS WHICH ARE NOT INSURABLE AT RATES THAT WOULD PERMIT THE PRODUCT TO BE MADE AVAILABLE TO THE PUBLIC AT REASONABLE COSTS. CLEARLY, ADJUSTMENTS IN THE INSURANCE INDUSTRY AND IN THE TORT LIABILITY SYSTEM MUST BE MADE IF SMALL BUSINESS IS TO SURVIVE THIS VERY CRITICAL TIME.

EVEN THOUGH MANY SMALL FIRMS HAVE NOT HAD CLAIMS, INSURANCE IS BASED ON THE PRINCIPLE OF SPECIFIED GROUPS SHARING THE LOSSES OF THE INDIVIDUAL MEMBERS OF THE GROUP. PERIODIC ADJUSTMENTS IN PREMIUM RATES, ALONG WITH OTHER CARRIER INCOME SHOULD BE SUFFICIENT TO COVER PROJECTED LIABILITY LOSSES. OUR

INSURANCE SYSTEM, HOWEVER, HAS CEASED TO PROPERLY FUNCTION.

CSMA BELIEVES THAT THE CRISIS IN THE COST AND AVAILABILITY OF LIABILITY INSURANCE UNDERSCORES THE URGENT NEED FOR PRODUCT LIABILITY REFORM. SPECIFICALLY, CSMA SUPPORTS THE ENACTMENT OF NATIONAL, UNIFORM PRODUCT LIABILITY STANDARDS. LEGISLATION SHOULD PROVIDE UNIFORMITY AND CERTAINTY IN AREAS SUCH AS PUNITIVE DAMAGES, STATUTES OF LIMITATION AND REPOSE, SUBSEQUENT REMEDIAL MEASURES, AND WORKERS COMPENSATION. CSMA ALSO SUPPORTS THE EFFORT TO COMBINE PRODUCT LIABILITY REFORM WITH A COST EFFECTIVE ALTERNATIVE TO TORT LITIGATION. IF SUCCESSFUL, SUCH AN EFFORT COULD PRODUCE A SYSTEM WHICH PROVIDES CLAIMANTS WITH A SWIFT MEANS OF RECOVERY AND WHICH REDUCES TRANSACTION COSTS FOR BOTH CLAIMANTS AND MANUFACTURERS. ANY ALTERNATIVE TO THE TORT SYSTEM, HOWEVER, MUST NOT DRASTICALLY INCREASE TRANSACTION COSTS AND IT MUST NOT ALLOW CLAIMS FOR WHICH RECOVERY FROM A PRIVATE PARTY CANNOT BE SOCIALLY JUSTIFIED.

CSMA URGENTLY REQUESTS THIS COMMITTEE TO CAREFULLY EXAMINE THE INSURANCE PROBLEM AND OUR SUGGESTED SOLUTIONS. ONCE HAVING DONE SO, WE REQUEST THAT THIS COMMITTEE, IN CONJUNCTION WITH OTHER CONGRESSIONAL COMMITTEES INVESTIGATING THIS PROBLEM, PUT ITS SUPPORT BEHIND A BILL INCORPORATING THE PRINCIPLES WHICH WE HAVE DISCUSSED TODAY. WE REMAIN COMMITTED TO SOLVING THIS VERY CRITICAL PROBLEM AND OUR MEMBERS ALONG WITH STAFF ARE AVAILABLE TO WORK WITH THE COMMITTEE TO OFFER ASSISTANCE.

WE THANK YOU FOR THIS OPPORTUNITY TO TESTIFY, AND, WE WILL BE PLEASED TO RESPOND TO QUESTIONS THAT THE COMMITTEE MIGHT HAVE.

Founded 1914

CONFIDENTIAL

Suite 1120
1001 Connecticut Avenue, NW
Washington, DC 20036

CHEMICAL SPECIALTIES MANUFACTURERS ASSOCIATION

202/872-8110

INSURANCE CRISIS
QUESTIONNAIRE

As many of you know, major industries in this country are experiencing difficulty in obtaining product liability and other types of insurance coverage. In those instances where coverage is available, costs have escalated alarmingly in the last year. This situation has hit the chemical specialties industry especially hard.

In an effort to assist member companies during this insurance crisis, it is necessary to ascertain the extent of this problem among member companies and how they are responding.

We would appreciate your taking a few minutes to fill out the questionnaire which follows. The results will be used by CSMA and its Small Business Council as the basis for testimony at hearings on the availability and affordability of property and casualty insurance before the Senate Small Business and other Committees of Congress.

Since these hearings are tentatively scheduled to be held soon after the Congress reconvenes on January 21, 1986, we ask your assistance by responding to this questionnaire on or before January 15, 1986. Responses should be directed to the attention of Terre Belt, Legislative Coordinator, at CSMA headquarters. Thank you for your assistance.

QUESTIONNAIRE

1. What types of insurance coverage does your company require to operate? Please indicate dollar limit you require for each type of coverage.

Comprehensive General Liability $__________
Product Liability $__________
Environmental Impairment Liability
    sudden/accidental $__________
    gradual pollution $__________
Broad Form Vendors Coverage $__________
Umbrella Coverage $__________
Casualty Coverage $__________
Officers & Directors Coverage $__________
Other $__________

2. Have you been able to obtain insurance coverage in the following areas?

	Yes	No
Comprehensive General Liability	______	______
Product Liability	______	______
Environmental Impairment Liability		
sudden/accidental	______	______
gradual pollution	______	______
Broad Form Vendors Coverage	______	______
Umbrella Coverage	______	______
Casualty Coverage	______	______
Officers & Directors Coverage	______	______
Other	______	______

3. Have you been turned down by an insurance company for any of the following coverages?

	Yes	No
Comprehensive General Liability	______	______
Product Liability	______	______
Environmental Impairment Liability		
sudden/accidental	______	______
gradual pollution	______	______
Broad Form Vendors Coverage	______	______
Umbrella Coverage	______	______
Casualty Coverage	______	______
Officers & Directors Coverage	______	______
Other	______	______

4. Has your insurance carrier reduced your coverage from prior years for any of the following coverages?

	Yes	No
Comprehensive General Liability	______	______
Product Liability	______	______
Environmental Impairment Liability		
sudden/accidental	______	______
gradual pollution	______	______
Broad Form Vendors Coverage	______	______
Umbrella Coverage	______	______
Casualty Coverage	______	______
Officers & Directors Coverage	______	______
Other	______	______

5. What reason was given by your insurance carrier for reduction or cancellation or non-renewal of policies?

A. Insufficient net worth__________
B. Bad loss history__________
C. Lack of or insufficient safety/risk management programs

within company__________
D. No reason given__________
E. High Risk products__________
F. Other______________________ ______________________________

6. Has the cost of your insurance coverage increased significantly in the last year?__________If so, by how much?

100% __________; 250% __________; 500% __________
750% ________; 1,000% or more __________; other _______%

7. What impact has this cost increase had on your business?

A. Very little__________
B. Closing business__________
C. Going without insurance__________
D. Layoffs__________
E. Business expansion plans curtailed__________
F. Drastically reduced profitability__________
G. Self-insurance__________
H. Pooling resources with other similar companies to insure the group__________
I. Other____

8. What internal measures are you taking at your facilities to deal with risk management and safety precautions techniques?

A. Capital improvements__________
B. Employee safety training programs__________
C. Routine safety information periodically updated and disseminated to employees__________
D. Auditing for compliance with safety regulations__________
E. Environmental auditing__________
F. Other____

9. In what way(s) do you communicate proper risk management and safety handling procedures for your products to your customers?

A. Written material (MSDS)__________
B. Other written safety and handling information (be specific)____
C. Provide technical support to customers to assure safe handling____________
D. Compliance auditing to assure proper handling by your customers____________
E. Determination of customer compliance with applicable hazard communication requirements including MSDS, labeling and employee training programs. In event of non-compliance, suggest remedial actions________________
F. Other____
____

10. How many individuals does your company employ?

A. 0- 10________
B. 10- 50________
C. 50-100________
D. 100-250________
E. 250- 350__________
F. 350- 500__________
G. over 500__________

11. Please check your gross sales category.

A. up to $100,000__________
B. $100,000-250,000__________
C. $250-1,000,000__________
D. $1-5 million__________
E. $5-25 million__________
F. $25-100 million__________
G. over $100 million__________

12. In what State(s) are your facilities located?__________

13. In what congressional district(s) are your facilities located?

COMPANY NAME__________

Individual Name__________

Title__________

Address__________

Telephone__________

Senator **Pressler**. Thank you.

Mr. Danny Coleman, owner, Powerscourt and Dubliner Restaurants, Washington, DC. We welcome you.

Senator **D'Amato**. Mr. Chairman, if I might on the lighter side say Dan Coleman and his family have been long-time constituents of mine from Syracuse, NY, where I went to college and law school. He is a great proprietor, active in NFIB, and I recommend Powerscourt to you any time for a great meal.

Senator **Dixon**. Well, and I must add to that, Mr. Chairman, not only Powerscourt but the Dubliner is a delightful place that I go to from time to time.

You have the capable prejudice of this committee on your side.

STATEMENT OF DANIEL J. COLEMAN, OWNER, POWERSCOURT AND DUBLINER RESTAURANTS, WASHINGTON, DC

Mr. **Coleman**. Thank you, Mr. Chairman. It is a delight to appear before this stacked deck. I was honored when Senator Weicker asked me to appear before this committee, and I am grateful to have the opportunity to air my frustrations over this entire liability insurance issue. It has now gotten to the point where insurance could easily put me out of business and maybe out on the street.

I would like to point out that there is a typo in my written statement. I couldn't afford a secretary after I had paid my insurance premium.

As you know, I own two small restaurants on Capitol Hill, and I have also recently been elected president of the Washington Restaurant and Beverage Association. In that capacity, I know about the insurance problems of other restauranteurs in the Washington area.

The most immediate and critical insurance problem we have is liquor law liability or dram shop insurance. In the District of Columbia, there is no explicit dram shop statute. The District of Columbia Court of Appeals has never addressed the issue.

Even though the U.S. Court of Appeals has recently ruled in *Norwood* v. *Marrocco* that there is no dram shop liability in the District of Columbia, the insurance companies continue to proceed on the assumption that dram shop liability does exist.

In preparing my testimony, I reviewed my insurance rates over the past several years, and if I look and sound confused, it is because I am. It is impossible to compare apples and apples when shopping for insurance or even in comparing the same coverage on the same property year after year.

For the first several years that the Dubliner was open from 1972 to 1974, I paid approximately $100 a year for liquor law liability. It was just a rider on the general liability policy. For the policy that ran from 1982 to 1983, the coverage cost $1,500. The next policy year the premium doubled to $3,000. In 1984, they really went crazy, and they quoted me a premium of $30,000 to cover $90,000 in liquor sales. At my rate of liquor sales, at $1 million a year, my premium would have been $333,000. I checked with my insurance agent yesterday to see if I slipped a digit, and I didn't. He assured me that that is the correct number.

Senator Dixon. Mr. Chairman, I know that you want to hear all the witnesses, but could I interrupt at this moment? This really intrigues me.

You see, I am a Senator from Illinois, Mr. Coleman. In my State, we do have a dram shop law. Actually, it is a dram shop law that limits the amount of your liability. When I was a kid in the legislature, I went to the House in 1951, a few years ago, and in those days, the tavern people wanted to appeal the law, and now I think they like it on the grounds that it at least lets them know what the limits of their liability are.

But if I understand your testimony, and I want you to correct me if I am wrong, you are saying there is no dram shop law in the District of Columbia. Yet, you pay thousands of dollars for insurance coverage against a dram shop lawsuit. Is this your testimony?

Mr. Coleman. Yes. There is no dram shop statute.

Senator Dixon. Can I pursue that a moment? Are there from time to time verdicts in the District of Columbia predicated on a theory of a violation of law where a dram shop serves a fellow who gets drunk and runs up on the sidewalk and kills somebody? Are there any such cases? What I am trying to find out, Mr. Chairman, is there actual exposure. Have there ever been lawsuits?

Mr. Coleman. Yes. As recently as January 7, 1986, in the U.S. Court of Appeals, it was *Norwood* v. *Marrocco.* The court ruled that there was no dram shop liability in the District of Columbia.

Senator Dixon. You see, this is the thing that I think is rather remarkable.

Mr. Coleman. As recently as last night, Hartford told me that I could not get liquor law liability insurance next year.

Senator Dixon. Well, I sure hope, Mr. Chairman, that we will pass this along to the appropriate jurisdictional committee that handles matters affecting the District of Columbia which is, as you know, a matter that comes under our jurisdiction, because unless I misinterpret what Mr. Coleman is saying to me, and I would be interested in being corrected about this, I think you are saying there is no dram shop law, and I think you are saying there is no known liability exposure to the companies. Yet, they are charging thousands of dollars in fees. That is quite remarkable. I would like to pursue that at some length.

Mr. Coleman. Well, I think I would agree with your colleagues in Illinois. I would rather there was a dram shop law with limits set so at least I could get insurance. I can't get insurance now. The next guy who sues me owns the Dubliner.

Senator Pressler. This illustrates the point that if one State adopts limitations, they don't get any lower insurance rates. That is what has been found. So, the insurance companies seem to just do it. They don't reward a State or a jurisdiction for having different practices.

Senator Dixon. May I say, Mr. Chairman, are you a lawyer by any chance?

Senator Pressler. I am.

Senator Dixon. Well, I am, too, and what I think is remarkable here I believe that the witness is testifying there is no known case of liability in the District. I believe that is what he is saying.

Mr. Coleman. That is right.

Senator DIXON. And yet he is paying thousands of dollars for insurance for a nonexposure situation. I think it is quite remarkable.

Mr. COLEMAN. I couldn't pay it.

Senator DIXON. I am going to pursue this further, Mr. Coleman, if I am the only Member of the Senate who does. I will tell you that right now.

Mr. COLEMAN. I would be delighted.

Senator DIXON. And I may come over to the Dubliner and have a jar of your extra Guinness and discuss this with you further.

Senator D'AMATO. I told Senator Dixon better yet, lunch at Powerscourt.

Senator DIXON. All right.

Mr. COLEMAN. Well, obviously, I feel this situation has gotten out of hand, and I am very aware of the emotional issues related to alcohol service and abuse. I am the father of six small children, and I am violently opposed to drunk driving and the service of alcohol to minors. I don't permit my employees to serve people who are drunk. I don't want a lot of noisy drunks in there while you are trying to enjoy your lunch. But I am in favor of people having a good time enjoying a pint of Guinness and enjoying our good food and entertainment.

I don't believe that law-abiding hosts, whether commercial or private, should be held responsible for the behavior of their guests after they leave. If I am fortunate enough to have a few Senators or Congressmen in for lunch, and after they enjoy a cocktail, they come back here and vote for Gramm-Rudman, I don't want the American people holding me responsible. [Laughter.]

I was going to say Simpson-Mazzoli if Senator Rudman was here. [More laughter.]

Anyway, I think that the entire situation could be rectified either by revising the tort or court system so that juries could not make huge awards not based on somebody's wrongdoing but on the size of their insurance policy or just by specific local statutes that either limit or eliminate liquor law liability. I really don't think it ought to be limited; it should be just eliminated. I shouldn't be held responsible.

I would appreciate it if the committee would permit the National Federation of Independent Business to submit some additional information on this subject, and thank you for the honor of appearing before your committee.

[The prepared statements of Mr. Coleman and the National Federation of Independent Business follow:]

TESTIMONY BEFORE THE UNITED STATES SENATE COMMITTEE ON SMALL BUSINESS - FEBRUARY 21, 1986

Gentlemen:

I was honored when invited by Senator Weicker and the National Federation of Independent Business to testify before your Committee. I am very grateful to have this opportunity to air my frustrations on this liability insurance issue that has perplexed and confused me for the past twelve years. It has not gotten to the point where it could very easily not only put me out of business, but put me out on the street.

I own and operate two small restaurants on Capitol Hill, The Dubliner and The Powerscourt, both located in the Phoenix Park Hotel. I have also recently been elected President of the Washington Restaurant and Beverage Association (WRBA) and in that capacity have been made aware of the insurance problems of many other restaurant owners in Washington, D.C.

The most immediate and critical insurance problem for me and other small restaurants that serve alcoholic beverages is the liquor law liability or "dram shop" issue. In the District of Columbia we do not have a "dram shop" statute explicitly authorizing a civil cause of action for damages resulting from the service of alcoholic beverages. In fact the District of Columbia Court of Appeals has not addressed this issue. Even though the United States Court of Appeals recently ruled in Norwood vs. Marrocco (No. 84-5416, January 7, 1986) that there was no "dram shop" liability in the District of Columbia, the insurance companies continue to proceed on the assumption that "dram shop" liability does exist.

In preparing for my testimony I reviewed my insurance rates over the past several years and if I look and sound confused it is because I am. The insurance companies have been very good at keeping their customers confused. It is impossible to compare "apples to apples" when it comes to shopping for insurance or even in my case, in comparing the same coverage, on the same property, year after year.

For the first several years The Dubliner was in business, 1974-82, the liquor law liability insurance was simply a rider on the General Liability Policy and cost approximately $100 per year additional. For the policy that ran from 1982-83, this coverage cost an additional $1500. The next policy (1983-84) the premium doubled to $3000 per year. In 1984 they really went crazy and quoted me a $30,000 premium to cover $90,000 in liquor sales. At that rate my insurance premium for $1,000,000 in alcoholic beverage sales would have been $333,000. I checked with my insurance agent yesterday to make sure these numbers were correct and he assured me they were.

For the policy year 1983-84 my Property and General Liability package cost $6,102, $3,000 of which was the liquor law liability insurance. The following year the same package cost $8,656 but did not include the liquor law insurance.

An associate of mine, who operates a restaurant on the House side of Capitol Hill has a lease that requires him to have liquor law liability insurance. In 1984 his premium was $7,336 for $5,000,000 coverage. In 1985 his premium jumped to $26,545 for $1,000,000 coverage. A 362% premium increase for 20% of the coverage. He had to buy it or be in violation of his lease agreement.

Generally speaking, in the District of Columbia, "dram shop" insurance is unobtainable if your alcoholic beverages sales are over 25% of your gross sales. This forces many restauranteurs to go without coverage and seriously jeapardizes our businesses.

BEST

I personally feel that this situation has gotten out of hand. I am aware of the emotional issues related to alcohol service and abuse. I am the father of six small children and am violently opposed to drunk driving and the service of alcohol to minors. But, I am strongly in favor of people having a good time, relaxing with a pint of Guinness and enjoying our good food and entertainment. I do not believe that law-abiding hosts, whether private or commercial, should be responsible for actions of people to whom they serve alcoholic beverages. If I am fortunate enough to have a few Congressmen or Senators in for lunch and after they enjoy a cocktail or two, they go back to work and vote for Simpson-Mazzoli, I do not want the American people to hold me responsible!

This entire situation could be rectified either by revising the court system so that juries would not be allowed to make huge awards based not on someone's wrong-doing, but rather on the size of their insurance policy or by specific local statutes that eliminate the liquor law liability.

I would appreciate it if the Committee would allow the National Federation of Independent Business to submit additional information on this issue for the record and would like to thank you for the honor of appearing before your Committee.

Daniel J Coleman

Daniel J. Coleman

The Dubliner and The Powerscourt

Restaurants

520 North Capitol Street, NW

Washington, DC 20001

NFIB® National Federation of Independent Business
The Guardian of Small Business

SUBMITTED STATEMENT OF

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before: Senate Committee on Small Business

Subject: Insurance Availability and Affordability

Date: February 21, 1986

The National Federation of Independent Business (NFIB) represents over 500,000 small and independent businesses nationwide in all sectors of commerce. On a scale with their response to the divestiture of AT&T, NFIB members have universally expressed confusion and apprehension over another service component of business operations: commercial liability insurance.

For the past six months we have been contacted regularly by members complaining about insurance unaffordability and, in some cases, unavailability:

--A laundromat owner in Corpus Christi was sued because a lady was mugged in one of his laundromats. He refused to pay, but his insurance company settled with the lady out of court. Last year he paid $900 for $2 million in coverage. This year he is paying $3,625 for $1 million in coverage.

Federal Legislative Office
[illegible] Maryland Avenue SW
Washington DC 20024
202 554-9000

--A small chemical company (14 employees) in Gulfport, Mississippi paid $4500 for $300,000 coverage. This year they have been quoted a premium of $38,000 for $500,000 coverage.

--A campground in Hagerstown, Maryland last year was charged less than $1000 for $1 million in coverage. This year the same coverage costs $8000.

--A plumbing and heating contractor in Warren, New Jersey received notice that his policy had been cancelled without explanation.

--An aircraft corporation in Waco, Texas paid $25,000 in 1983, $50,000 in 1984, and $200,000 in 1985 for $2 million in coverage.

--A five-and-dime store in New Lexington, Ohio has seen premiums increase 20% between 1984-1985 and 50% between 1985-1986.

--A manufacturer of food processing machinery in Marblehead, Ohio paid $50,000 with a $2500 deductible in 1985. This year the premium is $150,000 with a $50,000 deductible. This year's policy would also require the manufacturer to pay legal expenses for settling claims and to provide a letter of credit to the insurer in the amount of $300,000.

--An elevator repair and maintenance company on Staten Island paid $3500 for $5 million coverage in 1984. In January 1985 the policy cost $17,500. In July 1985 the policy was cancelled. Another carrier has offered coverage for $72,000 in annual premiums.

--An auto parts and towing company in Walton, Ohio is being charged $20,000 this year for coverage which cost $11,000 last year.

--An insurance agent in Boundbrook, New Jersey received notice from two companies that they were no longer accepting any applications for commercial liability insurance. Also, these companies were reviewing all renewals for possible termination.

In addition to hearing directly from our own members, we have heard from hundreds of small businesses at the White House Conferences on Small Business. These conferences are being held in every state prior to the national conference, which will be held in Washington in August. At these conferences, small business owners vote on recommendations for federal action on small business issues. The top new issue coming out of these conferences is insurance. With over half of the conferences completed, insurance has emerged as the foremost concern aside from the budget and taxes.

Small business is in a Catch-22 situation when it comes to liability. Legal counsel at certain times and insurance all of the time are necessities. However, legal counsel is expensive; in-house counsel is out of the question. With regard to liability coverage, self-insurance, and in most cases group insurance, are not options for small business. Currently, obtaining certain lines of coverage on the open market may be virtually impossible.

We know that all types and sizes of businesses are experiencing a major problem with almost all commercial lines of insurance. We believe that the solution must be comprehensive enough to address what we see as the multiple causes of the problem.

The Causes

There is, as you know, disagreement on the circumstances which led to the current crisis. The main dispute is between the insurance industry and the trial lawyers. The insurance industry lays most of the blame for the situation on the attorneys and the civil justice system. They claim that excessive litigation, overly generous court awards, and greedy attorneys have strained insurance reserves and thus raised the costs of underwriting. While admitting that they underpriced insurance to gain investment capital when interest rates were high, they maintain that tort reform is the answer to the problem.

The attorneys accuse the insurance companies disclaiming the notion that Americans have become more litigious and that attorneys do little to discourage frivolous lawsuits. They contend that most of the problems are due to poor management of investments made by the insurance companies, and they point to the companies' strong performance in the stock market as evidence of the healthy financial status of the industry as a whole.

One other group must be mentioned. The insurance commissioners have done little fingerpointing except at erroneous predictions regarding interest rates, upon which they made many decisions. Although they must operate within statutory limits, they all have authority to review rates either before or after implementation. However, like state tort law, the theory and practice of insurance regulation varies widely from state to state.

We see some truth to all sides' arguments, and we propose consideration of several areas of reform. Before I elaborate, let me emphasize that we are still gauging membership opinion on most of these proposals.

The Solutions: Tort Reform

As you may know, NFIB is a charter member of the American Tort Reform Association (ATRA), a new coalition of business groups in favor of tort reform. NFIB membership supports tort reform at both the state and federal levels. In response to the question, "Do you favor or oppose comprehensive reform of the legal system to reduce litigation and limit the liability of defendants in civil suits?", our members voted 84% in favor, 5% opposed, 11% undecided. In twenty-four states, NFIB state directors have polled member opinions on various reforms of state tort law, and those results have likewise indicated their support. We support the following reforms, which many of the state legislatures are already considering:

1. Cap awards for noneconomic damages

2. Limit contingency fees

3. Implement alternative dispute resolution (ADR) mechanisms

4. Penalize parties that engage in frivolous litigation

5. Modify pure comparative negligence standards

6. Abolish joint and several liability

7. Require judges/juries to itemize elements of awards

8. Require judges/juries to consider collateral sources of compensation in determining awards

9. Eliminate "ad damnus" causes

10. Allow payments of awards in installments

Solutions: Industry Reform

A major concern of ours is the exercise of discretion by insurance companies in cancelling or not renewing policies. Notification periods are often short, and little if any explanation is given to the policyholder. Claims history seems to have no bearing on an insurer's decision to cancel or not renew. Industrywide cancellations leave insurance agents hard pressed to obtain coverage for clients, and small business owners have neither the time nor the expertise to seek out coverage for themselves.

At the state level, some insurance commissions have enacted temporary initiatives, such as moratoria on mid-term cancellations. Legislation is being considered in some states to require adequate notification periods and/or just cause for cancellations and nonrenewals. We support these actions as well as the formation of assigned risk pools and Market Assistance Programs (MAPs).

Another concern is the expanded use of claims-made policies for basic, commercial liability coverage. Claims-made policies are the insurance industry's immediate answer to the problem of unavailability because this type of coverage reduces the financial exposure of the insurance companies. According to industry representatives, claims-made policies are less expensive than occurrence policies. However, the cost of retroactive coverage to insure against liability incurred prior to the effective date of a claims-made policy, known as a "tail," will most likely neutralize, if not outweigh, any savings accrued through the initial purchase of a claims-made policy.

Claims-made policies have already been approved by most state insurance commissions and are being written by many companies. We urge strict monitoring of the implementation of these policies. Such oversight should be undertaken at the state level and possibly at the federal level as well. At the very least, insurance agents should be required to indicate clearly to policyholders the differences between the conventional occurrence policy and claims-made.

Solutions: Regulatory Reform

The existing regulatory system does not work. In contrast to the regulation of utilities, regulation of the insurance industry has not maintained available and affordable service, nor has it preserved the financial health of insurance companies. Insurance commissioners are charged with the responsibility of ensuring that rates are not "inadequate," "excessive," or "unfairly discriminatory," but the industry itself admits that policies were underpriced in the late 70's and early 80's. Many would contend that current premiums are excessive. Perhaps part of the problem is understaffing of commissioners' offices, which might be solved by earmarking more of the revenue collected in state premium taxes for this purpose.

The real problem, though, may be the political feasibility of a commissioner executing the powers of office. Consumers like low rates, and commissioners because they are either elected or appointed, like to please consumers. Without protection from public pressure, they may not be able to make unpopular decisions. One way to diffuse the political heat would be to create multi-member insurance commissions similar to the structure of most public utility commissions.

Another approach would be to establish statutory minimum standards pertaining to the financial condition of insurance companies. Such standards might be derived from the leverage and exposure ratios currently developed on an advisory basis by the

National Association of Insurance Commissioners (NAIC) for use by insurance companies and commissioners.

We do not at this time have a recommendation on whether industry and regulatory reforms should be undertaken at the federal level. However, we urge Congress to consider the reforms mentioned and to examine two other potential areas of concern. The McCarran-Ferguson Act has long been a source of controversy, but whether or not modification or repeal would improve the availability and affordability of insurance is uncertain. The other area of concern is reinsurance. The alleged influence of reinsurers over insurers has been publicized, as has the presence of foreign reinsurers in the American market. More information is needed in this regard.

Thank you for the opportunity to participate in this hearing. We look forward to working with you, Mr. Chairman and members of the committee, as you continue your consideration of insurance availability and affordability.

227T

Senator PRESSLER. Thank you very much.

Mr. Francis R. Carroll, president, Small Business Service Bureau, Inc., from the State of Massachusetts.

STATEMENT OF FRANCIS R. CARROLL, PRESIDENT, SMALL BUSINESS SERVICE BUREAU, INC., WORCESTER, MA

Mr. CARROLL. Thank you very much, Mr. Chairman.

By the way, it is nice to know we have some good company, because I was at the Dubliner last night myself. It is one of my favorite places in Washington.

Mr. Chairman, I am Frank Carroll, president of Small Business Service Bureau. I would like, however, to correct if I could, the committee list. I am representing Small Business Service Bureau and Small Business Insurance Agency, a small agency I own, and not Small Business United. So, if you could correct that.

The Small Business Service Bureau is a national organization of over 35,000 small businesses which employ under 50 employees. Mr. Chairman, I am bringing you the small business viewpoint, in our opinion, of the liability insurance crisis as the president of SBSB and also as the local owner of an insurance agency and as a founding member of the Conference of Insurance Legislators, COIL.

Due to the fact that the insurance industry, as we know, is regulated by the State and not the Federal Government, I offer the cooperation of COIL members and suggest that the committee share its testimony with COIL and the National Association of Insurance Commissioners, NAIC.

The committee should work to provide short-term relief from liability insurance increases and develop model legislation that can address the civil justice and insurance reform that is needed.

The liability insurance crisis is threatening the economic health of the entire Nation. The litigation explosion and subsequent skyrocketing insurance rates are responsible for business closings, higher taxes, higher health care costs, and higher prices for almost everything. Small businesses are being hit particular hard. SBSB members in every State are being confronted with premium hikes ranging from 50 to more than 2,000 percent, and some business owners have been unable to obtain coverage at any price. Many small businesses are finding that their only options are to go bare or go broke. Here are some examples of how the liability crunch is hurting small businesses, taken from our members' experiences.

I have submitted a whole list, Senator, but I thought I might like to point out a few important cases, as Mr. Coleman has done here.

We have a member in New Hampshire operating a sandblasting service who had to scrap plans for expanding his business and hiring more employees when his liability premium increased to equal his total annual sales.

A Massachusetts member operating a schoolbus company had to pay a $10,000 premium to obtain the same amount of coverage that had cost him $3,000 last year.

Another member not on the volume scale of the Dubliner but who operates a very small hotel and tavern experienced in Massachusetts a premium increase of more than 2,000 percent, from $600 to $13,000 in 2 years, and he has had only $15,000 in claims over 25 years of business. This does not include liquor liability coverage. In Massachusetts, you can only get limited coverage through a JUA.

The owner of an asbestos removal firm has been unable to find any insurance carrier willing to underwrite liability coverage. In this case, a vital service which is mandated by law cannot be performed because the provider of this service cannot obtain the coverage she needs to run her business.

A Virginia member who designs underground storage tanks for gas stations first saw his premium jump from $380 to $8,800. When a new Federal regulation was passed which authorized fines of $10,000 per day on each tank that was found to be leaking, insurance coverage could not be purchased at any price. Now that small business is out of business.

Additionally, many insurance carriers will now only write policies which will pay claims made during the policy period. This leaves many businesses exposed to a long trail of liability. A machinery manufacturer can be sued, as we heard earlier, for an accident caused by equipment made 20 years ago that may have been altered or poorly maintained. Unless you can produce a product which you are willing to guarantee forever against misuse, poor maintenance, or consumer stupidity, you better have a lot of money set aside to pay for lawsuits.

When a large corporation loses a liability lawsuit, the award is paid out of the corporation's assets. The personal assets of the owners and officers are protected. This does not hold true for small business where often corporate and personal assets are one and the same. Many small businesses secure loans with their homes and other major personal possessions. A single liability lawsuit can wipe them out.

Ironically, a large portion of the blame for this sorry state of affairs can be placed squarely on the shoulders of the insurance industry itself. During the late 1970's when interest rates were high, some greedy insurance companies engaged in cash-flow underwriting slashing premiums to expand their share of the market, resulting in rates which were too low to cover their risks.

As interest rates declined and claims increased, the insurance industry has reacted by pursuing an antiunderwriting policy. Entire lines have been canceled or refused renewal. Blanket premium hikes fail to distinguish between good and bad risks. The insistence of carriers in offering strictly claims-made policies is justified on the dubious premise that certain unpredictable risks cannot be separated from routine risks.

The legal system is also expensive and time consuming, spending nearly $3 in legal and administrative fees for every $1 awarded to plaintiffs.

Additionally, there is the misconception on the part of juries and the general public that no one is hurt by big damage awards because insurance companies are footing the bill. Jury awards in liability cases are often based on the ability of the defendant to pay, not on wrongdoing. While it may appear to a jury that a defendant with deep pockets is paying the claim, the truth is that the money is coming out of millions of little pockets in the form of higher premiums and higher prices.

Small Business Service Bureau believes that a multifaceted approach is needed. Many partial stop-gap measures have been implemented to date. The sliding scale limits on lawyer's fees in California has been upheld in the courts. Bills filed in many States seek to limit noneconomic awards or to further restrict the definition of reasonable doubt and liability itself.

The Senate Committee on Small Business we recommend and request should consider the following for State action:

Laws and regulations should limit or prevent cancellation of liability policies within a policy period.

Advance notice of 90 days should be required in any instance where an insurer will not renew a policy.

Uniformity of claims occurred application should be achieved to prevent an unfunded liability problem as is potential through claims made policies.

The SBA district and advocacy offices should assist individual business owners who are unable to purchase liability coverage. The SBA "800" line could be expanded to include information which could refer insureds to local carriers still writing coverage.

A systemized limit on attorneys' contingency fees must be enacted in each State.

Punitive damages should be applied only in cases when wrongdoing is truly beyond a reasonable doubt. Senator Danforth's bill, S.

1999, contains several constructive reforms that can be used in this effort. Some of them we don't support, but many of them we do: A more accurate definition of what constitutes liability; limitation on the length of time a business or individual may be held liable for harm to a claimant; and removal of a jury from the awards process in favor of judges who possess the experience and expertise to render an equitable and reasonable decision.

I respectfully urge the members of this committee to review S. 1999 and to support S. 100 as important initial steps to resolving the liability crisis.

With great difficulty, American small businesses have survived the high inflationary and high interest rates of the seventies. Now, they are being asked to overcome the single, in our opinion, most destructive problem since the Great Depression. Unless there is adequate intervention on their behalf to solve the liability insurance crisis, small businesses will continue to meet increasing disaster each day. It is already a universal threat to the well-being of each and every small firm in America, and as this sector of the economy sinks, so will the economic recovery.

I urge you to act quickly and decisively to prevent any further damage to small business. Let's keep the driving force behind the American economy in running condition.

Thank you.

[The prepared statement of Mr. Carroll follows:]

STATEMENT OF FRANCIS R. CARROLL, PRESIDENT, SMALL BUSINESS SERVICE BUREAU, INC.

GOOD MORNING MR. CHAIRMAN, I AM FRANK CARROLL, PRESIDENT OF SMALL BUSINESS SERVICE BUREAU (SBSB). SBSB IS A NATIONAL SMALL BUSINESS ORGANIZATION WITH 35,000 MEMBERS HEADQUARTERED IN WORCESTER, MASS. WE PROVIDE SMALL BUSINESSES AND NEW BUSINESS START-UPS WITH LEGISLATIVE ADVOCACY, MANAGEMENT ASSISTANCE, HEALTH INSURANCE AND OTHER BENEFITS AND SERVICES.

THIS MORNING I AM BRINGING YOU THE SMALL BUSINESS VIEWPOINT AS THE PRESIDENT OF SBSB, AND ALSO AS THE OWNER OF A LOCAL COMMERCIAL INSURANCE AGENCY (SBIA) AND AS A FOUNDING MEMBER OF THE CONFERENCE OF INSURANCE LEGISLATORS (COIL). DUE TO THE FACT THAT THE INSURANCE INDUSTRY IS REGULATED BY THE STATE, AND NOT THE FEDERAL GOVERNMENT, I OFFER THE COOPERATION OF COIL MEMBERS AND SUGGEST THAT THE COMMITTEE SHARE ITS TESTIMONY WITH COIL AND THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC).

THE COMMITTEE SHOULD WORK TO PROVIDE SHORT-TERM RELIEF FROM LIABILITY INSURANCE INCREASES, AND DEVELOP MODEL LEGISLATION THAT CAN ADDRESS THE CIVIL JUSTICE AND INSURANCE REFORM THAT IS NEEDED.

THE LIABILITY INSURANCE CRISIS IS THREATENING THE ECONOMIC HEALTH OF THE ENTIRE NATION. THE LITIGATION EXPLOSION AND SUBSEQUENT SKYROCKETING INSURANCE RATES ARE RESPONSIBLE FOR BUSINESS CLOSINGS, HIGHER TAXES, HIGHER HEALTH CARE COSTS AND HIGHER PRICES FOR ALMOST EVERYTHING. SMALL BUSINESSES ARE BEING HIT PARTICULARLY HARD. SBSB MEMBERS IN EVERY STATE ARE BEING CONFRONTED WITH PREMIUM HIKES RANGING FROM 50 TO MORE THAN 2000 PERCENT, AND SOME BUSINESS OWNERS HAVE BEEN UNABLE TO OBTAIN COVERAGE AT ANY PRICE. MANY SMALL BUSINESSES ARE FINDING THAT THEIR ONLY OPTIONS ARE TO "GO BARE" OR GO BROKE. HERE ARE SOME EXAMPLES OF HOW THE LIABILITY CRUNCH IS HURTING SMALL BUSINESS, TAKEN FROM OUR MEMBER'S EXPERIENCES:

- AN SBSB MEMBER IN NEW HAMPSHIRE OPERATING A SANDBLASTING SERVICE HAD TO SCRAP PLANS FOR EXPANDING HIS BUSINESS AND HIRING MORE EMPLOYEES WHEN HIS LIABILITY PREMIUM INCREASED TO EQUAL HIS TOTAL ANNUAL SALES;

- A MASSACHUSETTS MEMBER OPERATING A SCHOOL BUS COMPANY HAD TO PAY A $10,000 PREMIUM TO OBTAIN THE SAME AMOUNT OF COVERAGE THAT HAD COST HIM $3,000 LAST YEAR;

- ANOTHER MEMBER OPERATING A SMALL HOTEL AND TAVERN EXPERIENCED A PREMIUM INCREASE OF MORE THAN 2,000 PERCENT, FROM $600 TO $13,000 IN ONE YEAR, WITH ONLY $15,000 IN CLAIMS OVER A 25 YEAR PERIOD - AND THIS DID NOT INCLUDE LIQUOR LIABILITY;

- THE OWNER OF AN ASBESTOS-REMOVAL FIRM HAS BEEN UNABLE TO FIND ANY INSURANCE CARRIER WILLING TO UNDERWRITE LIABILITY COVERAGE. IN THIS CASE, A VITAL SERVICE WHICH IS MANDATED BY LAW CANNOT BE PERFORMED BECAUSE THE PROVIDER OF THIS SERVICE CANNOT OBTAIN THE COVERAGE SHE NEEDS TO RUN HER BUSINESS;

- A VIRGINIA MEMBER WHO DESIGNS UNDERGROUND STORAGE TANKS FOR GAS STATIONS FIRST SAW HIS PREMIUM JUMP FROM $380 TO $8,800. WHEN A NEW FEDERAL REGULATION WAS PASSED WHICH AUTHORIZED FINES OF $10,000 PER DAY ON EACH TANK THAT WAS FOUND TO BE LEAKING, INSURANCE COVERAGE COULD NOT BE PURCHASED AT ANY PRICE. HE IS NOW OUT OF BUSINESS.

- A TABLE SERVICE RESTAURANT IN NEW YORK WHICH SERVES AN OLDER CLIENTELE RECENTLY HAD ITS LIQUOR LIABILITY COVERAGE WITHDRAWN BY ITS INSURER. NOT A SINGLE CLAIM HAD EVER BEEN FILED AGAINST THE BUSINESS. LAST YEAR, THE OWNER PAID A $750 PREMIUM FOR $500,000 WORTH OF COVERAGE. HE NOW PAYS $980 FOR A $100,000 POLICY THROUGH ANOTHER INSURER. HE IS PAYING 30 PERCENT MORE FOR AN 80 PERCENT REDUCTION IN COVERAGE.

IN NEW HAMPSHIRE JUST LAST WEEK, 400 RESTAURANTS AND LOUNGES PARTICIPATED IN AN "UNHAPPY HOUR" TO PUBLICIZE THE IMPACT THAT LIQUOR LIABILITY COSTS ARE HAVING ON THEIR BUSINESSES. PARTICIPANTS IN THE "UNHAPPY HOUR" RAISED THEIR PRICES TO REFLECT THEIR LIABILITY PREMIUM INCREASES. AT ONE RESTAURANT, A BOTTLE OF BEER COST $14.25 AND A SNIFTER OF BRANDY COST $40.

ALTHOUGH THIS EVENT WAS STAGED TO RAISE AWARENESS OF THE LIABILITY INSURANCE PROBLEM, IT GRAPHICALLY UNDERSCORES WHAT CONSUMERS CAN EXPECT UNLESS THIS PROBLLEM IS IS ADDRESSED QUICKLY AND EFFECTIVELY. ALREADY PREMIUM INCREASES ACCOUNT FOR AS MUCH AS 30 PERCENT OF THE PRICE OF SOME PRODUCTS, WHILE OTHER PRODUCTS OR SERVICES HAVE BEEN COMPLETELY WITHDRAWN FROM THE MARKETPLACE.

AS A BUSINESS OWNER MYSELF, I WAS FORCED TO ELIMINATE SBSB's TELEX SUBSCRIBER SERVICE FOR OUR MEMBERS BECAUSE I COULD NOT OBTAIN ERRORS AND OMISSIONS LIABILITY INSURANCE AT ANY PRICE.

IT IS CLEAR THAT THE INNOVATIVE STRENGTH OF OUR ECONOMY IS BEING SAPPED BECAUSE OF THIS CRISIS.

THE QUALITY OF VITAL SERVICES SUCH AS HEALTH CARE IS ALSO BEING THREATENED. MANY DOCTORS PRACTICING HIGH-RISK SPECIALTIES SUCH AS SURGEONS, OBSTETRICIANS AND ORTHOPEDISTS ARE WALKING AWAY FROM THEIR PRACTICES DUE TO THE FLURRY OF MALPRACTICE SUITS AND GIANT PREMIUM HIKES. A PENNSYLVANIA SBSB MEMBER WHO IS A GENERAL PRACTITIONER COMPLAINED THAT 30 TO 40 PERCENT OF HIS INCOME IS BEING SWALLOWED UP BY MALPRACTICE INSURANCE PREMIUMS. SBSB CONSTANTLY HEARS THE FRUSTRATION AND ANGER OF OUR MEMBERS WHEN THEY SEE THEIR HEALTH CARE COSTS RISE AGAIN AND AGAIN, DUE IN PART TO DOCTOR'S DEFENSIVE MEDICINE AND THE SEEMINGLY ENDLESS UPWARD SPIRAL OF MALPRACTICE RATES.

THERE ARE ALSO MANY OTHER SELF-EMPLOYED PROFESSIONALS SUCH AS ACCOUNTANTS, ENGINEERS AND ARCHITECTS WHO ARE FINDING THEMSELVES VULNERABLE BECAUSE THEY LACK THE RESOURCES THAT LARGE COMPANIES HAVE TO PROTECT THEMSELVES FROM THIS TIDAL WAVE OF LITIGATION.

WHILE BIG COMPANIES AND THE INSURANCE INDUSTRY MANEUVER TO PROTECT THEMSELVES FROM THE DELUGE OF CLAIMS AND LAWSUITS, SMALL BUSINESSES ARE ON THEIR OWN. SOME SMALL BUSINESSES HAVE HAD THEIR POLICIES CANCELLED WITH NO ADVANCE NOTICE FROM THE INSURER, AND OTHERS FIND THAT EVEN IF THEY CAN OBTAIN COVERAGE, THEY CAN'T GET ADEQUATE PROTECTION.

LARGE CORPORATIONS CAN POOL THEIR RESOURCES AND SELF-INSURE, BUT SMALL BUSINESSES OFTEN HAVE NO CHOICE. IN ORDER TO OBTAIN A LIABILITY POLICY, MANY SMALL BUSINESSES ARE FORCED TO SWITCH ALL THEIR INSURANCE FROM ONE CARRIER TO ANOTHER. NOT ONLY ARE THEY BEING GOUGED BY EXORBITANT LIABILITY PREMIUMS, BUT THEY ARE DENIED THE FREEDOM TO SHOP FOR THE MOST COMPETITIVE PRICE FOR THEIR OTHER INSURANCE NEEDS.

ADDITIONALLY, MANY INSURANCE CARRIERS WILL NOW ONLY WRITE POLICIES WHICH WILL PAY "CLAIMS MADE" DURING THE POLICY PERIOD. THIS LEAVES MANY BUSINESSES EXPOSED TO A LONG TRAIL OF LIABILITY. A MACHINERY MANUFACTURER CAN BE SUED FOR AN ACCIDENT CAUSED BY EQUIPMENT MADE 20 YEARS AGO THAT MAY HAVE BEEN ALTERED OR POORLY MAINTAINED. UNLESS YOU CAN PRODUCE A PRODUCT WHICH YOU ARE WILLING TO GUARANTEE FOREVER AGAINST MISUSE, POOR MAINTENANCE OR CONSUMER STUPIDITY, YOU BETTER HAVE A LOT OF MONEY SET ASIDE TO PAY FOR LAWSUITS.

WHEN A LARGE CORPORATION LOSES A LIABILITY LAWSUIT, THE AWARD IS PAID OUT OF THE CORPORATION'S ASSETS. THE PERSONAL ASSETS OF THE OWNERS AND OFFICERS ARE PROTECTED. THIS DOES NOT HOLD TRUE FOR A SMALL BUSINESS, WHERE OFTEN CORPORATE AND PERSONAL ASSETS ARE ONE AND THE SAME. MANY SMALL BUSINESSES SECURE LOANS WITH THEIR HOMES, AND OTHER MAJOR PERSONAL POSSESSIONS. A SINGLE LIABILITY LAWSUIT CAN WIPE THEM OUT.

IRONICALLY, A LARGE PORTION OF THE BLAME FOR THIS SORRY STATE OF AFFAIRS CAN BE PLACED SQUARELY ON THE SHOULDERS OF THE INSURANCE INDUSTRY ITSELF. DURING THE LATE 1970'S, WHEN INTEREST RATES WERE HIGH, GREEDY INSURANCE COMPANIES ENGAGED IN CASH-FLOW UNDERWRITING, SLASHING PREMIUMS TO EXPAND THEIR SHARE OF THE MARKET, RESULTING IN RATES WHICH WERE TOO LOW TO COVER THEIR RISKS.

AS INTEREST RATES DECLINED AND CLAIMS INCREASED, THE INSURANCE INDUSTRY HAS REACTED BY PURSUING AN ANTI-UNDERWRITING POLICY. ENTIRE LINES HAVE BEEN CANCELLED OR REFUSED RENEWAL. BLANKET PREMIUM HIKES FAIL TO DISTINGUISH BETWEEN GOOD AND BAD RISKS. THE INSISTENCE OF CARRIERS IN OFFERING STRICTLY CLAIMS-MADE POLICIES IS JUSTIFIED ON THE DUBIOUS PREMISE THAT CERTAIN UNPREDICTABLE RISKS CANNOT BE SEPARATED FROM ROUTINE RISKS.

THE INSURANCE INDUSTRY TODAY IS NOT FULFILLING ITS FUNDAMENTAL FUNCTION IN THE MARKETPLACE. WHEN THEY FAIL TO DISTINGUISH BETWEEN DIFFERING RISKS, THEY ARE NOT TRULY UNDERWRITING, AND UNLESS THEY SPREAD APPROPRIATE RISKS, THEY ARE NOT TRULY PROTECTING THEIR RESERVES.

WHEN THE INSURANCE INDUSTRY FAILS TO ACT RESPONSIBLY AND POLICE ITSELF, THEN OTHER ALTERNATIVES MUST BE CONSIDERED. PARAMETERS FOR REGULATION SHOULD BE ESTABLISHED AT THE STATE LEVEL, SO THE INSURANCE COMPANIES ARE NOT ALLOWED TO REPEAT THIS FIASCO.

THE LEGAL SYSTEM HAS ALSO EXACERBATED THE PROBLEM. THE TORT SYSTEM IS TOTALLY DEVOID OF ANY CONSISTENT, PREDICTABLE STANDARDS. THE RESULT IS A PATCHWORK OF CONFUSING AND CONFLICTING STATE LAWS WHICH SPAWN LAWSUITS, RAISE INSURANCE PREMIUMS, AND INCREASE CONSUMER PRICES. LIABILITY LAWYERS EXPLOIT THIS SITUATION, SHOPPING AROUND TO PURSUE CASES IN THOSE STATES WHERE THEY CAN WIN THE HIGHEST AWARDS AND LINE THEIR POCKETS WITH FAT CONTINGENCY FEES.

THE LEGAL SYSTEM IS ALSO EXPENSIVE AND TIME-CONSUMING, SPENDING NEARLY $3 IN LEGAL AND ADMINISTRATIVE FEES FOR EVERY $1 AWARDED TO PLAINTIFFS.

ADDITIONALLY, THERE IS THE MISCONCEPTION ON THE PART OF JURIES AND THE GENERAL PUBLIC THAT NO ONE IS HURT BY BIG DAMAGE AWARDS BECAUSE INSURANCE COMPANIES ARE FOOTING THE BILL. JURY AWARDS IN LIABILITY CASES ARE OFTEN PREDICATED ON THE ABILITY OF THE DEFENDANT TO PAY, NOT ON WRONGDOING. WHILE IT MAY APPEAR TO A JURY THAT A DEFENDANT WITH "DEEP POCKETS" IS PAYING THE CLAIM, THE TRUTH IS THAT THE MONEY IS COMING OUT OF MILLIONS OF "LITTLE POCKETS" IN THE FORM OF HIGHER PRICES AND HIGHER PREMIUMS.

SMALL BUSINESS SERVICE BUREAU BELIEVES THAT A MULTI-FACETED APPROACH IS NEEDED. MANY PARTIAL STOP-GAP MEASURES HAVE BEEN IMPLEMENTED TO DATE. THE SLIDING SCALE LIMITS ON LAWYER'S FEES IN CALIFORNIA HAS BEEN UPHELD IN THE COURTS. BILLS FILED IN MANY STATES SEEK TO LIMIT NON-ECONOMIC AWARDS OR TO FURTHER RESTRICT THE DEFINITION OF "REASONABLE DOUBT" AND LIABILITY ITSELF.

THE SENATE COMMITTEE ON SMALL BUSINESS SHOULD CONSIDER THE FOLLOWING FOR STATE ACTION:

1. LAWS AND REGULATIONS THAT LIMIT OR PREVENT CANCELLATION OF LIABILITY POLICIES WITHIN THE POLICY PERIOD;

2. ADVANCE NOTICE OF 90 DAYS SHOULD BE REQUIRED IN ANY INSTANCE WHERE AN INSURER WILL NOT RENEW A POLICY;

3. UNIFORMITY OF "CLAIMS OCCURED" APPLICATION SHOULD BE ACHIEVED TO PREVENT AN UNFUNDED LIABILITY PROBLEM AS IS POTENTIAL THROUGH "CLAIMS MADE" POLICIES;

4. SBA DISTRICT AND ADVOCACY OFFICES SHOULD ASSIST INDIVIDUAL BUSINESS OWNERS THAT ARE UNABLE TO PURCHASE LIABILITY COVERAGE. THE SBA "800" LINE COULD BE EXPANDED TO INCLUDE INFORMATION WHICH COULD REFER INSUREDS TO LOCAL CARRIERS STILL WRITING COVERAGE;

5. A UNIFORM PRODUCT LIABILITY STATUTE ON A FEDERAL LEVEL SHOULD BE IMPLEMENTED;

6. JUDICIAL REFORM OF THE DEPTH AND EXTENT OF LIABILITY AND CLAIMS LIMITATION MUST BE ACHIEVED. OUR LAWS CANNOT BE AN EXCUSE FOR MISUSE OF PRODUCTS, THEY SHOULD PROVIDE ONLY THE PROTECTION AND RESTITUTION THAT IS APPROPRIATE, NOT SIMPLY WHAT IS AVAILABLE;

7. A SYSTEMATIZED LIMIT ON ATTORNEY'S CONTINGENCY FEES MUST BE ENACTED IN EACH STATE;

8. NON-ECONOMIC AWARDS SHOULD HAVE A MAXIMUM LEVEL;

9. PUNITIVE DAMAGES SHOULD BE APPLIED ONLY IN CASES WHEN WRONGDOING IS TRULY "BEYOND A REASONABLE DOUBT".

SENATOR DANFORTH'S BILL, S.1999, CONTAINS SEVERAL CONTRUCTIVE REFORMS THAT CAN BE USED IN THIS EFFORT:

10. A MORE ACCURATE DEFINITION OF WHAT CONSTITUTES LIABILITY;

11. DISINCENTIVES FOR THE PURSUIT OF FRIVOLOUS LAWSUITS, INCLUDING FINES AND PAYMENT OF THE DEFENDANT'S LEGAL FEES BY THE CLAIMAINT WHEN A LAWSUIT IS DETERMINED TO BE WITHOUT MERIT;

12. LIMITATION ON THE LENGTH OF TIME A BUSINESS OR INDIVIDUAL MAY BE HELD LIABLE FOR HARM TO A CLAIMANT;

13. REMOVAL OF A JURY FROM THE AWARDS PROCESS, IN FAVOR OF JUDGES WHO POSSESS THE EXPERIENCE AND EXPERTISE TO RENDER AN EQUITABLE AND REASONABLE DECISION;

14. RESTRICTION OF PUNITIVE AND NON-ECONOMIC DAMAGES.

I RESPECTFULLY URGE THE MEMBERS OF THIS COMMITTEE TO REVIEW S.1999 AND TO SUPPORT S.100 AS IMPORTANT INITIAL STEPS TO RESOLVING THE LIABILITY CRISIS.

WITH GREAT DIFFICULTY AMERICAN SMALL BUSINESSES HAVE SURVIVED THE HIGH INFLATION AND HIGH INTEREST RATES OF THE SEVENTIES. NOW THEY ARE BEING ASKED TO OVERCOME THE SINGLE MOST DESTRUCTIVE PROBLEM SINCE THE GREAT DEPRESSION. UNLESS THERE IS ADEQUATE INTERVENTION ON THEIR BEHALF TO SOLVE THE LIABILITY INSURANCE CRISIS, SMALL BUSINESSES WILL CONTINUE TO MEET INCREASING DISASTER EACH DAY. IT'S ALREADY A UNIVERSAL THREAT TO THE WELLBEING OF EACH AND EVERY SMALL FIRM IN AMERICA. AND AS THIS SECTOR OF THE ECONOMY SINKS, SO WILL OUR ECONOMIC RECOVERY. I URGE YOU TO ACT QUICKLY AND DECISIVELY TO PREVENT ANY FURTHER DAMAGE TO SMALL BUSINESS. LET'S KEEP THE DRIVING FORCE BEHIND THE AMERICAN ECONOMY IN TOP RUNNING CONDITION. THANK YOU.

Senator **Pressler**. Thank you very much, and let me say that I appreciate the specific solutions which you have suggested, because that is the kind of thing we need from business and from citizens. We do have a problem, but we also need to work on solutions, and I am going to ask you some questions about those solutions later.

First of all, let me ask Michael Nystrom, the president of Aerostar International in Sioux Falls, a very practical question. What effect do these increasing insurance rates you describe have on employment in the Sioux Falls area?

Mr. **Nystrom**. I think that any time we have any manufacturer in Sioux Falls, there is only so much money available for him to devote to his business. If you are forced to spend an excessive amount on your insurance premiums, you are not free to use that money to expand your business and to promote it.

Senator **Pressler**. That certainly is true, but has Raven Industries or Aerostar cut back or reduced, or has this otherwise affected employment yet?

Mr. **Nystrom**. No, I don't think it has. It hasn't affected employment. I think we have been trying to be as aggressive as we can at selling our product to try to make up the cost of the excess insurance.

Senator **Pressler**. What percentage of the cost of your product is insurance?

Mr. **Nystrom**. It will run at least over half of the selling price of the product.

Senator **Pressler**. Over half the selling price?

Mr. **Nystrom**. Right.

Senator **Pressler**. Now, can accidents that occur with balloons be traced to faulty construction or are they faulty operation? How are you drawn into these suits?

Mr. **Nystrom**. We get drawn in because we built the balloon. We haven't had a very significant problem. We have had a couple of lawsuits, and in both cases, it has always been at least investigated by the FAA and then most rational people looking at it see a pilot error situation. But we do have insurance and, because of that, we have ended up having to pay—our insurance company has had to pay a couple of claims.

Senator **Pressler**. How has the doctrine of joint and several liability affected your business operations?

Mr. **Nystrom**. As far as from the insurance point of view, as I understand it, we face the problem that a jury may determine that we were 10 percent liable, and yet because of our capability, we end up paying 100 percent of the settlement.

Senator **Pressler**. If the other guy in the lawsuit doesn't have any money.

Mr. **Nystrom**. Right.

Senator **Pressler**. If you are 1 percent liable, you might pay the whole damage if you have the deep pocket. Is that right?

Mr. **Nystrom**. That is right.

We deal with a lot of our dealers and distributors out there, in effect small business people who don't have a lot of assets. They sometimes may promote or could potentially have some reason for causing a problem. Yet, they more than likely would never face a lawsuit because they have no assets to draw upon.

Senator PRESSLER. Let me ask you this. What do you suggest as a solution to this problem? Perhaps you would like to submit that in writing to the committee.

[Subsequent information was received and follows:]

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March 6, 1986

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Russell Senate Office Building
Washington, D.C. 20510

Dear Mr. Popolo:

The following is in response to Senator Pressler's request on page 40, lines 11,12,13.

I suggest that any new products liability legislation deal with the doctrine of joint and several liability in the following manner.

In product liability law suits where juries determine cash settlements are appropriate, the juries should also determine the percentage of guilt of each and every defendant. Each defendant should then pay a percentage of the total settlement equal to his percentage of guilt. This would eliminate the current situation which occurs when a manufacturer that is thought to be as little as 1% guilty can still be responsible for 100% of a settlement.

Regards,

Michael L. Nystrom
President

MLN/dmb

Enclosure

A Subsidiary of Raven Industries, Inc

Mr. Nystrom. I guess I think what we need is a uniform liability law across the States and potentially could put some caps on claims and a more uniform way of determining what settlements should be.

Senator Pressler. Let me ask you, Mr. Carroll, I thought it was fascinating the solutions you suggested. You suggested several specific solutions. By the way, tell me now again what the Small Business Service Bureau is.

Mr. Carroll. The Small Business Service Bureau is a national private small business organization. We have 38,000 small business people who employ under 50 employees.

Senator Pressler. Under 50. But you are not a lobbying group.

Mr. Carroll. No, we advocate the purposes of legislative advocacy on a State and national level, management assistance, services to small business, and we offer benefits and services.

Senator Pressler. You had about two pages of solutions to the problems which I thought was very brave and good. You were critical of both the insurance companies and the legal profession. You say here that the insurance companies have made some unwise investments and they are not selecting good risks and so forth.

Would you just expand on that, on page 5? And later you were critical of the legal profession. Would you repeat your feelings about the insurance companies?

Mr. Carroll. My criticism of the insurance companies goes back several years, Senator, because I am one of the founding members of the Conference of Insurance Legislators.

Senator Pressler. You are one of the founding members of what?

Mr. Carroll. The Conference of Insurance Legislators, COIL. I was the small business member of the Industry Advisory Committee. But my criticism of the insurance companies goes back to during the high days of inflation to those chief executive officers of the insurance companies who wanted to gain market share by cutting premiums and going after the market shares so they could work up the float which was more important than sound underwriting practices.

In our opinion, they are trying to make up for those errors today by increasing premiums to the tune of what they claim is $3 to $4 billion a year. It seems as though every time they increase a premium—for an example as I used in my testimony. Take a small restaurant. First of all, you heard Mr. Coleman over here give you a small restaurant that goes from $300 to $13,000 in 2 years and in 25 years of business has not had more than $15,000 in claims. That is just on the small hotel portion, not counting his liquor liability which, of course, as you know, in Massachusetts the insurance industry pulled out of the market until they just recently formed a JUA. Even then, all the liquor owner can buy now in Massachusetts is a maximum of $500,000 liability and $1 million combined.

Then, of course, you had changes in the legal profession in the sense of more lawsuits and more jury awards. We felt that some of them were unjustified.

However, I guess what I really alluded to in terms of the legal profession was the report from California that I gave that it was $3 in administrative costs for every dollar paid the claimant. So, my criticism of the insurance companies was not in general of all companies because, frankly, if you go back over the last 10 years, you will find that many companies who are solid today in the property casualty business—I am not an expert on property casualty, Senator—but you will find a lot of these companies did not slash their prices, and they are healthy today where the other companies who are arbitrarily pulling out of the market are repeating the product liability crisis of many years ago where they said, OK, we have a product liability crisis because there was a lawsuit over here, and yet they probably didn't have a lawsuit on their books for that particular industry.

Senator **PRESSLER**. I would address this to Mr. Coleman and to Mr. Gullickson. We know there are some horror stories out there. But if you were advising the Federal Government to pass a bill tomorrow addressing this, what would it include?

Mr. **COLEMAN**. Mr. Chairman, as far as liquor law liability goes, it seems that the only time we get sued is if there is some money in it for the trial lawyers. Nobody ever slaps us with a paternity suit because our patrons get too amorous after they leave, because there is no money in it. [Laughter.]

I mean, the whole thing is crazy. The only time we are responsible is if somebody has a vehicular problem, it seems. I don't see why we should be held responsible for the behavior of our guests after they leave as long as we are law abiding and we don't serve them when they are drunk. There is no way that we can control them, so we shouldn't be responsible.

I just think that the law should be changed so that there is no liquor law liability.

Mr. **GULLICKSON**. I guess there are general from a chemical standpoint, from a chemical exposure standpoint in the hands of a consumer, we have some stories that would curl your hair about misuse of a product and the law suit resulting. One of the more frustrating areas for us as a company is the shotgun approach used by the legal profession where they sue the entire industry, big companies, little companies, everybody, distributors, packagers, the whole 9 yards, so you have a defendant list that covers three pages of a subpoena.

My personal reaction to that is that that is an attempt just to get a settlement from somebody. One of the ways of preventing, to my way of thinking, where an injury has actually occurred is the tort reform provisions that Senator Danforth has put forth in the Senate with the alternate compensation system in addition to some redefinition of negligence, as I understand it.

Now, I am not a lawyer, so I can't address the various definitions of negligence as they are presently applied across 50 different definitions or 51 or whatever it is now. A uniformity of that alone would probably be a great help.

But I think this alternate compensation system for people who are hurt by a product through little or no fault of their own that right now under the tort system, most of them wait 5 and 6 years for any kind of compensation. If there were a way to speed that up, I think that could be very beneficial.

Senator **PRESSLER**. Thank you. I shall now call on Senator Bumpers.

Senator **Bumpers**. Mr. Chairman, I just had one question.

Mr. Coleman, on the dram shop law, that is, as I remember from when I was in law school, that is an issue that has been around for almost 100 years. Do you think Congress ought to preempt the field dealing with that particular issue, or do you think it should be left to the States?

Mr. **Coleman**. Well, sir, I am not an attorney, but as I understand the constitutional amendment that repealed prohibition, it prohibits the Federal Government from dealing with the control and sale of alcoholic beverages. So, it probably constitutionally has to be left to the States.

If there is any way the Federal Government could do it, I would certainly be in favor of it.

Senator **Bumpers**. I have no further questions, Mr. Chairman.

Senator **Pressler**. Thank you.

I want to thank this panel very much. I know you have traveled great distances, and we will use your testimony. We will get it to the appropriate committees, and we thank you.

We now will call forward—and perhaps Senator Bumpers would like to introduce some members of the next panel—James Lienhart, president, Arrow Coach Lines, Little Rock, AR; Kenneth Green, president, Oklahoma Liquefied Gas Co., Seminole, OK; William Zehnder, owner, Frankenmuth Bavarian Inn, Frankenmuth, MI, representing the National Association of Restaurants; and John Polk, Council of Small Enterprises, Cleveland, OH, representing Small Business United.

I am going to have to turn this over to Senator Bumpers for 30 minutes. I am going over to the Commerce Committee where I have to make a statement, and then I am going to run back.

Senator Bumpers [acting chairman]. Gentlemen, welcome this morning. Mr. Lienhart, a special welcome to you from the great State of Arkansas.

Mr. **Lienhart**. Thank you, sir.

Senator **Bumpers**. We are glad to have you here. Since your name is first on the list, why don't you lead off.

Mr. **Lienhart**. OK.

STATEMENT OF JAMES LIENHART, VICE PRESIDENT IN CHARGE OF OPERATIONS, ARROW COACH LINES, LITTLE ROCK, AR

Mr. **Lienhart**. First of all, I would like to say I wish I had Jim McMahon's sunglasses so I could see something. It is pretty bright.

Senator **Bumpers**. Gentlemen, incidentally, I notice most of your statements are fairly short, but if you could summarize at any point, we would appreciate that. Your entire statement will be submitted for the record. If you can cut any of it out and state it simply, that will be fine.

Mr. **Lienhart**. Mr. Chairman, my name is Jim Lienhart, and I am vice president in charge of operations of Arrow Coach Lines of Arkansas. We are a small business. We own 15 coaches for charter operations.

On January 10, our liability coverage ended and we were forced to find new insurance. As a result, we had a hard time finding insurance. In fact, we couldn't find insurance at all. So, we ended up in the Arkansas assigned risk pool.

As a consequence, our premiums went from $2,000 per year per bus to over $13,000 per year per bus. As a result of this, we have had to increase our rates per mile 17 percent, from $1.60 to $1.80 per mile. It is very hard to do in this age of deregulation to increase your rates that much. It is very hard with the competition that is out there.

We have also had to cut down on the number of buses we have on insurance. We are trying to get fewer buses to do the same amount of work that 15 or 16 buses had done before to save on insurance and operating costs. As a result of cutting down the buses, we have had to lay mechanics off and we have also had to lay drivers off.

We have tried some alternative forms of insurance, one being we have run bare on our collision. We have no collision insurance. The only thing we are purchasing right now is liability insurance. And there is no deductible on our liability insurance right now. We tried to get with the insurance companies to add a deductible, say, $100,000 or something onto it, but they won't even talk to us. They won't have anything to do with the bus operators. They don't want your business. The only reason they are doing it is because they have to under the assigned risk pool.

We have also looked into the possibility of self-insuring. We can't do that right now. but I think there is something before the ICC to make it easier for small businesses to self-insure, and we would certainly be interested in this if anything ever happened where we could do it.

The amount of money we are having to spend on our liability insurance now is going to be close to $200,000 per year, and paying that amount every year, you could certainly have enough saved up to self-insure. That may be with a letter of credit from a bank or something.

The reaction from other small bus owners is much the same as mine. They are having the same problems finding insurance, and most of them are ending up in the assigned risk pool like we are. They have some problems that we don't have, fortunately for us. They have to pay their insurance premiums up front in one lump sum whereas we can pay ours out in three or four payments over the year. And they are having to go to the banks and borrow money in order to pay this large amount, and they are having to pay interest on top of the loan. So, they are losing twice, really, and it is something that the State commissions have done to penalize them, I think. I think it is a very biased thing to do, because we are able to pay our payments quarterly or something like that.

Also, in Arkansas, we are able to add buses and take buses off of our insurance policy where other operators in other States can't. For instance, this January, we had 4 buses on insurance although we had 10 licensed. Other operators in Louisiana I know of may have 15 buses, and they may only operate 2 or 3 in the month of January, but they have to have insurance on all 15 of them. When you are paying over $1,000 a month for each bus, it leaves you in the hole, and there is no way they can ever come out of it.

One thing we think that the Federal Government might be able to do, one thing that came out in our meeting in New Orleans that we attended, was to make the person who brings a lawsuit pay for the lawsuit and all the lawyers' fees if they lose that lawsuit.

So many of the lawsuits we have been in were frivolous lawsuits. One lady said that something fell on her foot in the bus, and she reported it about 2 years after it happened. These are very frivolous lawsuits, and we think if that person had to pay for all the litigation if she lost, which she did, it would keep some things out of the courts.

Another thing that some States have done and might not be a bad idea on the Federal level is to put a $250,000 cap on bodily injury. Also, we think in the long run it would be a lot easier and a lot better on small business if it would be easier for them to self-insure. I think this is a long-run solution to the problem.

In closing, Mr. Chairman, I would like to say that the bus industry is in a very sorry state because of this insurance crisis, and I hope I have shed some light on the problems. I thank this committee for letting me be here today.

[The prepared statement of Mr. Lienhart follows:]

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
February 21, 1986

Mr. Chairman, my name is James Lienhart. I am Vice President in charge of Operations at Arrow Coach Lines, a family-owned Arkansas corporation, one which has been operating for more than 40 years.

Arrow Coach Lines was founded in 1944 by my father, Henry Lienhart. Operating responsibility now falls upon my mother, sister, brother and me.

In spite of the fact that we have had to mothball some buses to save insurance costs, Arrow's fleet constitutes 15 coaches, all in topflight condition, one of them a deluxe, almost new Greyhound-type coach (MCI 96A3) from the 1985 model year.

In addition to Arrow Coach Lines, I speak today for United Bus Owners of America (UBOA), a trade association made up of 2300 bus owners, companies similar to Arrow. Of the 2300 total, more bus operators than are enrolled in any other trade association, 1700 rely upon UBOA to provide the insurance protection which is needed if they are to continue in business. It is an irony that UBOA member companies are paying drastically higher premiums than was the case in the recent past, premiums that have skyrocketed even though the group has offered insurors loss ratio that is below 50%.

Take Arrow's example. Since January 10, we have been in the Arkansas assigned risk pool. Our premiums have shot up from $2500 per bus, per year, to an astronomical $13,000 a year per bus.

Under a provision of the Bus Regulatory Reform Act of 1982 (Bus Act), minimum liability coverage for any bus seating more than 15 passengers, increased on November 19, 1985, from $2.5 million to $5 million. Although we are told that the increased coverage is not responsible for the premium rise, it is obvious that the added $2.5 million in coverage puts a crushing burden on the dollar reserves an insuror must retain in order to stay solvent.

Arkansas does offer one advantage that is not universally available. Arrow is able to raise or lower the number of buses on which insurance is purchased. We have a flexibility that not everyone enjoys.

The fact that Arrow is in the Arkansas assigned risk pool is a measure of the way in which the insurance problem is measured best, at the State level. I know of no Federal Insurance Commission, but each State has such an office. Also, I understand why neither the Administration nor the Congress is exactly anxious to establish a Federal insurance presence. After all, we do have a fixed purpose of lowering, rather than increasing, the costs of government. Proposed elimination of the Small Business Administration is a case in point.

On the other hand, there are ways in which this Committee and the Congress could be helpful. I propose that ICC be asked by this Committee, or by some other committee having cognizance, what steps have been taken to enable small bus owners to undertake self-insurance. My understanding is that coverage of the first million is the major liability hurdle. At the rates being paid by

Arrow, one million in premiums will have been paid in just a few years. Just a small amount of sympathetic involvment by the agency should make it possible to self-insure on the first million.

Insurance companies argue that high premiums are the result of huge pay-outs based on ridiculous court decisions, actions which would not have been started, were it not for the contingency fee system for attorneys: No win, nc pay.

The lawyers say we blame the victim, that the only courtroom door which is open to a poor person is that were the knob is turned by a lawyer who will take a case on a contingency basis. The possibility of getting anything at all prompts the injured party to agree to contingency fees as high as 40 or even 50 percent. Lawyers are unable to resist doing absurd things in the prospect of ridiculous fees. The tort system is savaged. The Arrow Coach Lines of the world are ruined by insupportable insurance costs.

Asked why they do not fight outrageous court cases, insurance providers say that, on one side of the scale, they place the weight of history of court decisions in the type of case being brought; and on the other, the amount being asked for settlement out of court.

That may be reasonable, but, once in court, the innocent bystander, as bus owners sometimes are, should be protected against outrageous judgments. I believe it's called "tort reform," placing limits on the amounts that may be seen to be justified.

One of the reasons, for UBOA's favorable loss ratio is its underwriting policy. Too often, I'm afraid insurance companies, themselves, have been to blame for high losses. With high interest rates, insurance companies went after the fast premium dollar, were tempted to tread lightly on being sure the high level of risk was worth the meager premium income.

Arkansas has been mentioned, is worth mentioning again. Although Federal law requires $5 million in liability protection, a bus moving entirely within Arkansas need carry only $100,000 protection, an amount which is too low. I wouldn't, willingly, take a bus on the road with such small coverage. And yet, were I to have buses moving only in intrastate commerce, the insurance carrier would provide only the absurdly small level of protection.

Mr. Chairman, it is quite possible that, this morning, I am appearing twice before you, for the first time and the last time. Quite directly, unless relief is provided, Arrow Coach Lines may very easily be driven off the road by insurance costs. At one shot, our insurance costs increased by 500 per cent, a real dollar level that is simply too heavy for us to carry. With passage of the Bus Act, thousands of people went out and bought buses. Now those people find that they can't afford to keep the buses running. The shake-out of ICC insurance revocations threatens to be as dramatic as was the number of ICC applications in 1983.

Mr. Chairman, I am vastly encouraged to see the concern being evidenced by this Committee. I have hope that you will find ways to relieve the insurance-cost burden being carried by small bus owners. Until recently, Arrow Coach Lines prided itself on being a good-sized company. At one time, e had as many as twenty buses. Now, we see that we are as much at risk as the one-bus operator who wangled a bank loan that can't be paid. A little while ago, A Georgia farmer saved his farm by committing suicide. Even death is not the answer for a bus owner. There is nothing that can be paid off; the insurance assessments keep coming.

I hope that my statement has revealed the anxiety I have for Arrow Coach Lines and for the bus industry generally. I hope a useful suggestion or two has been offered. Arrow Coach Lines and UBOA are honored to have been invited to appear. I will be happy to try to respond to any questions. Thank you Mr. Chairman.

Senator **BUMPERS**. Thank you very much, Mr. Lienhart.

I guess we are going to stay in proper sequence here. The next witness will be Mr. Kenneth Green.

STATEMENT OF KENNETH GREEN, PRESIDENT, OKLAHOMA LIQUEFIED GAS CO., SEMINOLE, OK

Mr. **GREEN**. I am Kenneth Green. I am president of Oklahoma Liquefied Gas Co. I am here to represent not only my company but the dealers in Oklahoma as well as the National LP Gas Association on the problems we are having with liability insurance.

Oklahoma Liquefied Gas Co. has been around since 1937, and we service nearly 5,000 home users and industrial accounts with not only their needs, but also motor fuel and recreational uses. We wholesale to other dealers, and we are a common carrier of LP gas. We do approximately $6 million a year in annual sales.

In September 1985, we received a cancellation notice that our insurance carrier would not renew their December 20 first anniversary. That was the first anniversary of a 3-year policy. They gave the reason that no reinsurance was available, and they had to not renew our insurance policy. The could have given us a 10-day notice. I guess we were very lucky in that respect.

It didn't sound as gloomy as you might think, because we had been looking for insurance for 2 or 3 months, and we felt that we wouldn't have any problem finding it. We had had some good loss ratios. We contacted quite a few large agencies. They said there would be no problem. They said our loss ratios—they are in the table, but I will just summarize them.

We paid premiums of $370,000 with losses paid out of $51,000 for a loss ratio of 0.138 or 13 percent. Six large agencies which were shopping nationwide said that they felt it would be no problem getting adequate and affordable coverage for Oklahoma Liquefied Gas.

We felt this would probably mean a 25- to 30-percent increase in our premium.

After about 2½ months, we realized that coverage at any price might be a real problem, because many insurance companies could not find renewal groups that would take the surplus until after the 1st of the year, and the major company we wanted to write with said they couldn't take any new policies until the 1st of January.

Our renewal came due, you might say, at the worst possible time. On the afternoon of December 19 when our renewal was going to be the next day, we had not found any insurance. We were ready to go to the State agency or the State fund which we knew wouldn't meet all of our needs, but fortunately, that wasn't necessary.

Our insurance company found an alternate insurance source. You might say they found them so they would be off the hook. They had to show that insurance was available to us. The alternate source would provide 5 percent of the coverage we had had. They would give us a $300,000 policy rather than the $6 million policy we had had. The cost would be $417,000 where we had paid $113,000 for the $6 million coverage.

Also, if we went with this policy and decided we didn't want to keep it for the full term of 1 year, they would charge us by the month, which would probably be around $18,000 per month, and they would also charge a cancellation fee of approximately $89,000. I don't need to tell you that in our small business, a $417,000 premium would be far greater than our cash flow or profits for a year.

Fortunately, at that time, the Association Insurance Company of Texas had been formed in 1972 and, 3 months prior to this date, had tried to service Oklahoma with insurance coverage. Just 3 days prior to our problem, they had been allowed to write insurance in the State of Oklahoma. Six hours before termination, we were bound by the Texas group. We had no idea what the premium would be, but we felt it would be better than what we had been offered.

It turned out that for less coverage, $5 million versus $6 million, and with much higher deductibles, we were able to secure insurance for $250,000 versus the $113,000 we had paid the year before. Now the problem was how to pay the premium. Our 1986 budget definitely couldn't afford it.

We reduced our work force by 25 percent, letting 10 employees go over a 45-day period. We had to start parking equipment, removing the insurance to stand-by status, and we were selling any surplus equipment that we didn't need.

We have also talked to neighboring dealers in Kansas and Colorado. A Kansas dealer went from a $200,000 a year premium to $700,000, and they are even having difficulty finding insurance at that. They, too, are having trouble making the premium payments.

When asked what could be done to help our problem, I think to reduce the $5 million requirement down to $1 million would be a stop-gap measure that would help us for now, because we just can't afford the $5 million coverage, and we have always carried in excess of $5 million. We felt it was a wise thing to do back when an umbrella was $11,000 where today it is $75,000. But now we feel that is impossible or will become impossible to comply with.

I think in the long term, we just need more reasonable insurance rates, and that is probably going to happen through a better trial system so that the awards are more within reason.

Thank you, Senator.

[The prepared statement of Mr. Green follows:]

Testimony Concerning
The Cost and Availability
of Liability Insurance for Small Business
Before The
Senate Small Business Committee
February 21, 1986

My name is Ken Green and I am President of Oklahoma Liquefied Gas Company, headquartered in Seminole, Oklahoma. I am here today speaking on an issue which is having a great impact on our company as well as our business companions across the country, liability insurance. In the next few minutes I would like to share with you the nightmarish experience our company has just been through concerning this colossal insurance dilemma.

First I would like to give a little background information on our company. Oklahoma Liquefied Gas is a medium size independent propane distributor serving some 5000 residential and commercial accounts with propane gas in central Oklahoma. This propane is used mainly for home and industrial uses when natural gas is not available, however there are also other uses such as motor fuel and recreational uses. We also wholesale and truck propane gas to other dealers throughout Oklahoma. Our total yearly revenue is approximately $6,000,000.

Our insurance problems began in September of 1985 when we received a cancellation notice from the insurance carrier at that time. The cancellation was to take effect December 20, 1985, the anniversary date of the policy. At this time we were in the first year of a three year contract. However, as it turned out, only ten days notice was required to cancel this contract. The reason for this cancellation was stated as the inability to renew with the reinsurance company who was getting out of this particular market entirely.

As gloomy as it might sound, this news did not alarm us at that time. We had already began looking into coverage for 1986 and had been assured by several agencies that coverage for a company with our track record would be no problem. This track record refers to our loss ratio, losses paid to premiums earned, over the three previous years. The table below illustrates these numbers.

YEAR	PREMIUM EARNED	LOSSES & EXPENSES PAID	LOSS RATIO
1983	$169,243	$28,862	.171
1984	88,589	-0-	.000
1985	113,018	22,234	.197
TOTALS	$370,850	$51,096	.138

With a total of six large agencies confidently shopping nationwide and this loss ratio, we felt it would be no problem to locate adequate and affordable coverage. To us affordable meant no more than an anticipated 25 to 30 percent premium increase.

Over the next two and one half months we discovered that finding coverage, at any price, was far from easy. One by one the different agencies began to drop out unable to find coverage. It seemed a few companies had some interest in our business but could not get the reinsurance necessary to write the business until after the first of the next year, too late for us. As it turned out our renewal was coming due at the worse possible time.

On the afternoon of December 19th, the final day of the existing policy, we had decided we would close business the next day and go to the State Insurance fund for help. Fortunately for us, as it turned out, this was not necessary. Two other options came available with one being acceptable. One option came available when one of the agencies was able to secure coverage from a specialty insurance company. The shocking news was the premium for this coverage. For only 5% of the coverage we had had, $300,000 limits vs. $6,000,000 limits, we were looking at a premium of $417,000 vs. $113,018 for the previous year. This increase by the way was more than our total projected cash flow for the entire year.

The second option, which turned out to be our solution, came about when we found out the Association Insurance Company of Texas was licensed to do business in Oklahoma. This group had been doing business in Texas since 1972 with propane dealers throughout the State. They had applied to do business in Oklahoma three months earlier and just three days prior to our deadline were granted approval to do so. Anticipating this licensing, we had mailed an application just in case it came through in time to help us. Just six hours before our coverage terminated we were bound by the Texas group.

At this time we had no idea what our premiums would be, but felt sure they would be much less than the $417,000 quote and would give us adequate coverage. Just recently we received our final premium figures. With one million less coverage, $5,000,000 vs. $6,000,000 and higher deductibles, our premiums increased to $250,000 compared to the $113,018 for 1985.

Now that we have the coverage, we have begun the process of figuring out how we can pay the premiums. The insurance problem coupled with the existing economic depression in our state has caused us to go back to the drawing board on our 1986 budget. We have already eliminated nearly 25 per cent of our work force, ten employees in the last 45 days. We have plans to park some of our equipment, remove insurance, and attempt to liquidate it. In some cases the new insurance premiums actually make some equipment too costly to operate. This is especially true of the equipment which we are required by Section 30 of the Motor Carrier Act of 1980 to carry $5,000,000 of insurance coverage on.

As we communicate with other propane dealers across the country we find they too are experiencing similar crisis concerning their liability insurance. One dealer in Kansas has received a preliminary quote of over $700,000 for his new coverage compared to $200,000 for his existing coverage. Others are finding adequate coverage nearly impossible to locate. In Oklahoma, dealers view the insurance crisis as having a similar negative impact as the current depressed oil prices.

We feel the Federal Government can assist propane dealers like ourselves immediately by reducing the $5,000,000 insurance limit required by Section 30 of the Motor Carrier Act of 1980 to $1,000,000. We have in recent years carried in excess of $5,000,000 of coverage and were doing so before it was law. However, we feel the cost and/or availibility will make this law virtually impossible to comply with.

This is only a partial answer to the problem and only effects a certain segment of our industry. We feel as do other businessmen we have conversed with, that the long term solution is to control insurance rates through a more judicious handling of settlements with a move towards a fair and reasonable limitation of liability lawsuits.

This concludes my testimony and I'll be happy to answer questions.

Senator **Bumpers**. Thank you very much.

Mr. Zehnder, welcome and please proceed.

STATEMENT OF WILLIAM A. ZEHNDER, GENERAL MANAGER, FRANKENMUTH BAVARIAN INN, FRANKENMUTH, MI

Mr. **Zehnder**. Thank you, Mr. Chairman, for the opportunity to appear before this committee this morning.

I am a firm believer that in America, if something is wrong, we have always fixed it, and I hope that I will be able to contribute to the understanding that there is a real problem in America of finding available and affordable liquor liability and general liability insurance, so we can again fix it.

My name is Bill Zehnder, and I am the general manager of the Bavarian Inn Restaurant located in Frankenmuth, MI. My family left the farm just before the Depression——

Senator **Bumpers**. Mr. Zehnder, let me interrupt you just a moment with something I forgot a while ago, Mr. Green. Senator Nickles wanted to be here to introduce you this morning. Unfortunately, he couldn't be here, but he did send a statement nominating you as the second Messiah which I will enter into the record. [Laughter.]

Mr. **Green**. I thank the Senator.

[The prepared statement of Senator Nickles follows:]

Don Nickles

OKLAHOMA

Statement of Senator Don Nickles
The Cost and Availability of Liability Insurance for Small Business
February 21, 1986

Mr. Chairman:

It is my pleasure to introduce to the committee, Mr. Kenneth Green, President of the Oklahoma Liquefied Gas Company. As Mr. Green will testify, he has been hit very hard by increased cost and reduced availability of liability insurance.

His premiums have escalated more than 75 percent over last year and his coverage has been dramatically reduced. In Oklahoma, where the economy is struggling, an increase in cost such as this threatens the existence of the company.

To alleviate this problem, a coalition of Oklahoma trade associations has been formed to examine and implement possible solutions. Their research has found a dramatic increase in premiums charged to businesses. On the average, the assessment for architects has increased 300 percent, 100 percent for dentists, 100 to 300 percent for trucking, and 50 to 200 percent for retail grocers. These increases come at a time when most of these businesses are reeling from the economic conditions in the state and cannot afford the added expense.

In the area of medical malpractice, the problem has become so severe that medical services are being restricted. For example, about 60 percent of all practicing obstetricians-gynecologists have been sued for malpractice. It has reached a point where a significant portion of the doctors have stopped delivering babies.

I am pleased the Small Business Committee has taken on the task of examining this important issue. I hope we can develop an appropriate legislative solution.

Senator **Bumpers**. I am sorry, Mr. Zehnder. Go ahead.

Mr. **Zehnder**. My family left the farm just before the Depression to go into the restaurant business. We have had deep roots in our family business, but it was through perseverance and attention to quality that we have grown from a small boarding house to a large restaurant seating 1,200 guests and employing over 500 full- and part-time employees.

As a family operated business, we take great pride in the fact that we serve over 750,000 meals each year. Like any responsible business, we have purchased insurance to protect ourselves in the unlikely event that a customer might injure himself while on our premises. In the last 59 years, we have never been sued for a general liability or a liquor liability claim.

As you can see in the written statement on this bar graph, our increases in premiums are astonishing. We really don't know how to deal with them. In fact, they were so high that we felt that the insurance companies had the decimal point in the wrong place.

Even with our spotless record, we are at the mercy of a tort system no longer serving the public's interest and insurance companies trying to recoup their losses. Let me reiterate, we are the victims of an industry economic cycle and a legal system gone awry.

Certainly, we have the choice of not carrying insurance or going bare. Years ago, it used to be bare bars or nude bars were places you didn't go, but a lot of family operations are now going bare, so to speak. However, we feel it is not right for us to risk almost 60 years of my family's blood, sweat, and tears, 50 years of upgrading building and reinvesting in our business, 50 years of providing employment for area residents, 50 years of paying local, State, and Federal taxes, and 50 years of supporting our community. We definitely feel that we need to have adequate and affordable insurance.

So, what should be done? I think there should be caps placed on defendant's liabilities. Cases should be governed by the principle of comparative negligence or percentage of responsibility. There should probably be a percentage cap attached to attorneys' fees, and there should be a reasonable notice of the liability claim provided by the plaintiff so that the defendant realizes there is a claim against him.

With an increase of over $150,000 in premium, my family is trying to figure out how to handle these large increases. Do we lay off staff? Do we raise our prices? Do we lower our quality? Do we reduce our profit sharing contributions? How do we compete with those businesses that do not carry insurance? How do we let our guests know that the insurance is more expensive than the gin in a gin and tonic? Where do we go from here?

My situation is not unique. There are operators in Michigan who have been up in arms for the last 2 years in this regard. This past week, I was a member of a national conference of independently owned restaurant operators from across the country. I learned that these restaurant operators all across the country are being victimized by this increase in insurance costs.

After sitting in this morning, I realize it is not just the restaurant industry which I have been very familiar with which is having these difficulties, not that there is any comfort in the numbers, but

I am sure that by sharing these real life experiences in operating a business, you have a better understanding of the crisis that we face.

Thank you for the opportunity to testify. I would be happy to answer any questions.

[The prepared statement of Mr. Zehnder follows:]

STATEMENT OF WILLIAM A. ZEHNDER, GENERAL MANAGER, BAVARIAN INN, FRANKENMUTH, MI

MR. CHAIRMAN, THANK YOU FOR THE OPPORTUNITY TO APPEAR BEFORE THE COMMITTEE THIS MORNING TO TESTIFY ABOUT THE SEVERE DIFFICULTY, CRISIS IF YOU WILL, THAT I AND OTHER FOODSERVICE OPERATORS ARE HAVING IN OBTAINING AFFORDABLE LIQUOR LIABILITY INSURANCE.

MY NAME IS WILLIAM ZEHNDER, AND I AM THE GENERAL MANAGER OF THE BAVARIAN INN, LOCATED IN FRANKENMUTH, MICHIGAN. THE INN IS A FAMILY BUSINESS, HAVING BEEN ESTABLISHED IN 1927 BY MY FATHER'S FATHER. OVER THE LAST THREE GENERATIONS WE HAVE SEEN OUR SMALL INN GROW INTO A LARGE-VOLUME RESTAURANT WHICH EMPLOYS APPROXIMATELY 500 PEOPLE IN FULL OR PART-TIME POSITIONS. MY FATHER, MOTHER, WIFE, SISTER, BROTHER-IN-LAW, AND OTHER MEMBERS OF OUR FAMILY OPERATE THE BUSINESS.

AS A FAMILY-RUN ENTERPRISE, WE TAKE GREAT PRIDE IN SERVING A VARIETY OF GERMAN FOOD AT AFFORDABLE FAMILY PRICES. OUR SPECIALTY IS CHICKEN. EACH YEAR OUR 1,200-SEAT INN PREPARES MORE THAN 200,000 CHICKENS, 227,000 POUNDS OF POTATOES, 200,000 LOAVES OF BREAD, AND SERVES A WIDE VARIETY OF BEER, WINE AND LIQUOR.

LIKE ANY RESPONSIBLE BUSINESS, WE HAVE TAKEN OUT GENERAL LIABILITY INSURANCE TO PROTECT OURSELVES IN THE UNLIKELY EVENT A CUSTOMER MAY INJURE HIMSELF WHILE ON OUR PREMISES. FORTUNATELY, IN THE PAST 59 YEARS WE HAVE HAD LITTLE NEED TO UTILIZE OUR POLICY AND THE COST HAS REMAINED FAIRLY CONSTANT, ADJUSTED FOR INFLATION, OVER THE YEARS.

SINCE WE ALSO SERVE ALCOHOLIC BEVERAGES, THE INN HAS LIQUOR LIABILITY INSURANCE, SOMETIMES REFERRED TO AS THIRD PARTY INSURANCE.

THIS COVERAGE IS DESIGNED TO PROTECT THE BUSINESS IN CASE A PERSON, DESPITE OUR EFFORTS TO PRECLUDE IT, OR WITHOUT OUR AWARENESS, SHOULD CONSUME TOO MUCH ALCOHOL AND LATER HARM HIMSELF OR ANOTHER PARTY DUE TO HIS INTOXICATED CONDITION.

IN THE ALMOST SIX DECADES WE HAVE BEEN IN BUSINESS, WE HAVE NEVER BEEN SUED ONCE FOR SERVING AN INTOXICATED PERSON WHO WAS LATER IN AN ACCIDENT. WE PRIDE OURSELVES ON HAVING A STRONG ALCOHOL EDUCATION PROGRAM FOR OUR SERVING STAFF. THE PROGRAM COVERS HOW TO RECOGNIZE A GUEST WHO IS BECOMING INTOXICATED, HOW TO CUT OFF SERVICE TO SUCH A GUEST, AND HOW TO KEEP AN INTOXICATED PATRON FROM DRIVING WHILE UNDER THE INFLUENCE. IT WOULD SEEM CLEAR THAT WITH THE RESPONSIBLE PRACTICES WE HAVE IMPLEMENTED, AND OUR HISTORY OF BEING FREE FROM LAWSUITS, THAT OUR LIABILITY INSURANCE PREMIUMS WOULD REFLECT THIS RECORD.

THE SAD TRUTH IS THAT MY FAMILY HAS BEEN STUNNED BY THE INSURANCE PREMIUMS WE ARE BEING REQUIRED TO PAY TO PROTECT OUR LIVELIHOOD. WE HAVE $500,000 GENERAL LIABILITY COVERAGE, $500,000 LIQUOR LIABILITY COVERAGE, AND AN UMBRELLA POLICY FOR AMOUNTS ABOVE $500,000. OUR LIQUOR LIABILITY INSURANCE PREMIUM HAS INCREASED 636 PERCENT IN THE LAST FIVE YEARS. OUR UMBRELLA POLICY PREMIUM HAS INCREASED 2,262 PERCENT! I HAVE ATTACHED GRAPHS TO MY STATEMENT WHICH ILLUSTRATE THIS DRAMATIC RISE.

THERE ARE THREE COMPANIES WRITING LIQUOR LIABILITY IN MICHIGAN. IN 1985, THE COMPANY WHICH PROVIDED OUR $500,000 LIQUOR LIABILITY coverage -- for a premium of $29,235 -- had no claims made against them, yet they would not offer more than $25,000 total coverage in 1986. This coverage would have been grossly inadequate, but it further depicts the problems faced today. Their decision was not due to a change in exposure (estimated liquor, beer and wine receipts for 1986 are to increase 5%) but rather a climate brought on by our legal system which makes insurance companies and proprietors unable to defend themselves.

Our situation, however, is not all that uncommon in the foodservice industry. The National Restaurant Association (NRA), the nation's leading trade association for my industry, and of which we are a member, engaged the Gallup Organization late last year to survey the industry and to develop some average figures. The results are astounding. Sixty-nine percent of the respondents reported increases in liquor liability premiums during the previous year, although 91 percent said they had never been named in a suit. The average increase was 110 percent: the average premium paid, $39,500.

NRA has catalogued many of the increases. One operator in Washington, D.C. saw his premium climb from $185 to $26,500 in one year. An operator in my home state saw his premium rise from $6,700 to $30,520. A restaurateur in New Jersey reported his total liability package rose from $25,000 to $92,000, and these cases go on and on in the vast majority of the states.

Even with our spotless record, the fact that we have to pay

THESE OUTRAGEOUS PREMIUMS IN ACTUALITY MAKES FOODSERVICE OPERATORS THE VICTIMS OF A TORT SYSTEM THAT IS NO LONGER SERVING THE PUBLIC INTEREST. THE INSURANCE COMPANIES ARE SYMPATHETIC TO OUR PLIGHT. HOWEVER, THEY TOO ARE SEEING THEIR PROFITS DROP DUE TO THE LARGE DECISIONS WHICH COURTS ARE HANDING OUT REGULARLY TO PEOPLE WHO HAVE BEEN VICTIMS OF ALCOHOL-RELATED ACCIDENTS. BY INCREASING THEIR PREMIUMS THEY CAN AT LEAST HEDGE THEIR BETS AGAINST A CONTINUATION OF THESE LARGE AWARDS. SO IN ESSENCE BUSINESSES SUCH AS MINE ARE STUCK IN THE MIDDLE. LET ME REITERATE THAT WE ARE THE VICTIMS OF AN INDUSTRY ECONOMIC CYCLE AND A LEGAL SYSTEM GONE AWRY.

CERTAINLY WE HAVE A CHOICE OF WHETHER WE CARRY LIQUOR LIABILITY INSURANCE. NOTHING OTHER THAN COMMON BUSINESS SENSE SAYS WE MUST DO SO. IN FACT, MORE AND MORE OPERATORS ARE UNABLE TO OBTAIN AFFORDABLE INSURANCE WHEN THEIR POLICIES EXPIRE. RATHER THAN PAY THE OUTRAGEOUS PREMIUMS REQUIRED BY INSURANCE COMPANIES, OPERATORS ARE TAKING THE ONLY OTHER STEP THEY CAN, SHORT OF CLOSING THEIR BUSINESSES. THEY ARE OPERATING WITHOUT INSURANCE, GOING BARE, HOPING THAT THROUGH STRICTER ALCOHOL SERVICE PRACTICES BY THEIR EMPLOYEES THEY CAN AVOID THE LAWSUIT THAT WILL FORCE THEM OUT OF BUSINESS AND TAKE AWAY EVERYTHING THEY HAVE WORKED SO HARD TO ACHIEVE.

IT HAS BECOME COMMONPLACE FOR PEOPLE TO SUE AND ASSUME THAT THE INSURANCE COMPANIES WILL COVER THE COSTS. SOCIETY AS A WHOLE SUFFERS FROM THE LARGE AWARDS BUSINESSES ARE FORCED TO PAY. WE PAY IT IN HIGHER INSURANCE PREMIUMS; WE PAY IT IN THE LOSS OF GOODS AND

SERVICES; WE PAY IT IN HIGHER CONSUMER PRICES; AN OVER LITIGIOUS SOCIETY PENALIZES ITSELF.

TO ELIMINATE OR AT LEAST REDUCE THIS KIND OF ABUSE, DRAM SHOP LAWS MUST BE REFORMED IN STATES WHERE THEY EXIST. THE NATIONAL RESTAURANT ASSOCIATION HAS PROPOSED SOME SPECIFIC CHANGES FOR STATES TO INTRODUCE. I SUPPORT THESE POINTS AND WOULD LIKE TO BRIEFLY OUTLINE THEM FOR YOU.

FIRST, DOLLAR CAPS SHOULD BE PLACED ON THE DEFENDANT'S LIABILITY. CAPS WOULD ASSURE A FAIR AND EQUITABLE RECOVERY FOR INJURED PARTIES. AT THE SAME TIME, THEY LEND THE KIND OF PREDICTABILITY TO AWARDS THAT THE INSURANCE INDUSTRY CLAIMS IS NECESSARY TO CURB UNREASONABLE PREMIUM INCREASES.

SECOND, LIQUOR LIABILITY CASES SHOULD BE GOVERNED BY THE PRINCIPLE OF "COMPARATIVE NEGLIGENCE" AND FINANCIAL LIABILITY BASED SOLELY ON THE DEFENDANT'S PERCENTAGE OF RESPONSIBILITY FOR THE ACCIDENT. THIS WOULD BE A MAJOR ATTACK ON THE "DEEP POCKET" SYNDROME, WHICH PLACES THE BURDEN ON INDIVIDUALS NAMED AS DEFENDANTS PRIMARILY BECAUSE THEY HAVE INSURANCE COVERAGE.

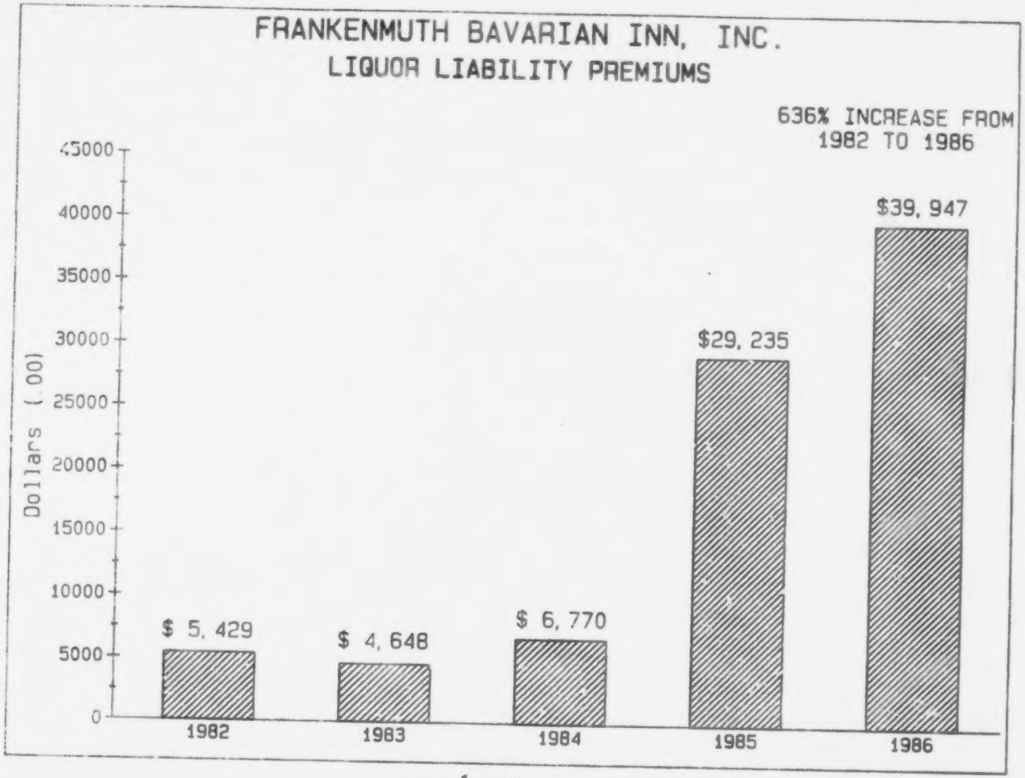
THIRD, REASONABLE NOTICE OF A LIQUOR LIABILITY CASE SHOULD BE PROVIDED BY PLAINTIFFS. CURRENTLY, THE DEFENDANT'S FIRST NOTICE COMES WHEN THE SUIT IS FILED. THAT IN TURN USUALLY OCCURS AT THE END OF THE STATUTE OF LIMITATION PERIOD, WHICH CAN BE TWO YEARS, THREE YEARS, OR EVEN LONGER. OFTEN BY THIS POINT IT IS IMPOSSIBLE TO RECONSTRUCT THE EVENT. FURTHERMORE, BECAUSE OF STAFF TURNOVER, IT MAY BE IMPOSSIBLE TO LOCATE THE INDIVIDUAL SERVER WHO MAY HAVE ANY KNOWLEDGE OF THE EVENTS.

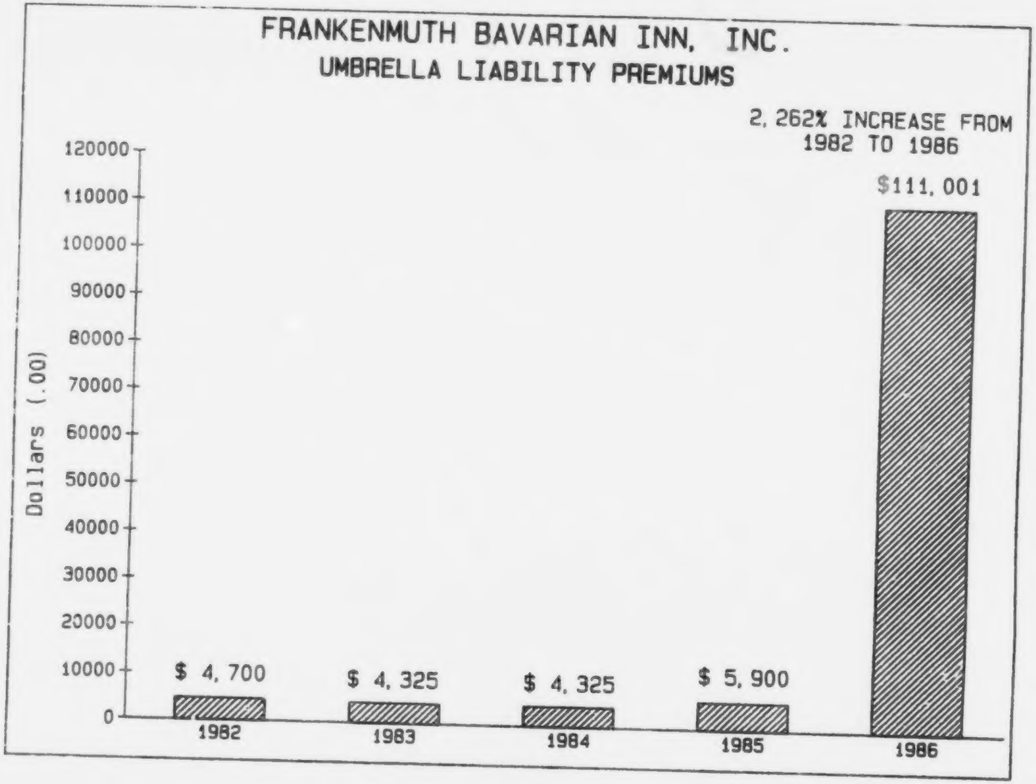
FINALLY, THE TIME PERIOD FOR FILING A SUIT UNDER THE STATUTE OF LIMITATIONS MUST BE REDUCED TO A REASONABLE TIME FRAME.

IT IS MY POSITION THAT THE CHANGES ARE WORTH SERIOUS CONSIDERATION BY THE INDIVIDUAL STATES AS THEY REVIEW THEIR DRAM SHOP LAWS.

WITH AN INCREASE OF SOME $153,694 IN EXTRA PREMIUMS FOR MY FAMILY'S BUSINESS TO ABSORB IN 1986, COSTS MUST RISE. HOW DO WE GO ABOUT PAYING FOR THIS OUTRAGEOUS INCREASE: DO WE LAY-OFF STAFF THAT IN MANY CASES ARE UNSKILLED AND HAVE LITTLE CHANCE FOR OTHER EMPLOYMENT? DO WE RAISE PRICES THAT OUR CUSTOMERS HAVE TO PAY FOR EACH MEAL THEY ARE SERVED, EACH BEVERAGE THEY ORDER? DO WE INSTITUTE A COMBINATION OF BOTH? SOMEWHERE, SOMETIME WE NEED TO STOP AND REALIZE WHAT WE AS A SOCIETY ARE DOING TO OURSELVES. MY SITUATION IS NOT UNIQUE. THOUSANDS OF YOUR CONSTITUENTS IN EVERY STATE IN THIS NATION ARE BEING CRIPPLED BY THIS VERY SAME PROBLEM. I HOPE THAT THROUGH SHARING WITH YOU MY "REAL LIFE" EXPERIENCES IN OPERATING A BUSINESS WHICH SERVES LIQUOR THAT YOU CAN BETTER UNDERSTAND THE CRISIS WE FACE.

THANK YOU MR. CHAIRMAN FOR THIS OPPORTUNITY TO TESTIFY BEFORE THE COMMITTEE TODAY, AND I WOULD BE PLEASED TO RESPOND TO ANY QUESTIONS.


FRANKENMUTH BAVARIAN INN, INC.
LIQUOR LIABILITY PREMIUMS
636% INCREASE FROM 1982 TO 1986
Dollars (.00)
45000
40000
35000
30000
25000
20000
15000
10000
5000
0
$ 5,429
$ 4,648
$ 6,770
$29,235
$39,947
1982
1983
1984
1985
1986



FRANKENMUTH BAVARIAN INN, INC.
UMBRELLA LIABILITY PREMIUMS

Senator **Bumpers**. Mr. Zehnder, to set the record straight, you have never had to refuse service to Senator Levin, have you?

Mr. **Zehnder**. No, not yet.

Senator **Bumpers**. Not yet?

Mr. **Zehnder**. Well, Senator Riegle comes there much more often.

Senator **Bumpers**. I take it you have had to refuse service to Senator Riegle. [Laughter.]

Mr. **Zehnder**. Actually, his mother is one of our best customers.

Senator **Bumpers**. He just eats more, so he is more noticeable.

Mr. **Zehnder**. I guess so.

Senator **Bumpers**. I have one other squawk; you are not serving enough chicken, 220,000 per year. You can improve on that.

Mr. **Zehnder**. You know, a lot of those chickens come out of Arkansas and Georgia and Alabama.

Senator **Bumpers**. Mr. Polk.

STATEMENT OF JOHN J. POLK, EXECUTIVE DIRECTOR, COUNCIL OF SMALLER ENTERPRISES, CLEVELAND, OH

Mr. **Polk**. Thank you, Mr. Chairman.

My name is John Polk. I am here today representing Small Business United. In real life outside of Washington, I am the executive director of the Council of Smaller Enterprises, affectionately referred to as COSE. COSE is the small business division of the Greater Cleveland Growth Association, Cleveland's Chamber of Commerce, and is the largest local small business organization in the United States with 7,000 member companies employing about 150,000 Greater Clevelanders.

Among the services which COSE offers its member companies is participation in one of the nation's largest group health care plans, and because of the size and success of these programs, our members are quite used to turning to COSE for their insurance needs. It is in that context that I first became personally aware of the nature and scope of our current crisis.

In July of last year, I began to receive calls from members, both business people themselves and their professional advisors, asking if there was any way COSE could assist members in obtaining liability insurance at more reasonable costs. I initially considered their problems to be symptomatic of simply the latest cycle in the insurance industry which is a pretty cyclical business, as I am sure you have heard.

By the fall, though, the number of calls we had received and the sense of urgency expressed by members indicated that there was something more serious than the latest business cycle at work. We are still receiving a steady couple of dozen calls a week on the problem today.

I have been told before by Members of Congress that the fact that some people are experiencing problems doesn't necessarily mean that a problem exists. So, over the past couple of weeks, I have spoken with an awful lot of my members, including all 35 members of my board, to see how widespread this problem really is. My directors are from every segment of industry, and their companies range in size from sole practitioners to a couple of hundred employees.

Of my 35 directors, all but 3 reported premium increases of at least 100 percent. Average rates of premium increase were between 300 and 500 percent, and virtually to a company, those premium increases bought a lower level of coverage, a reflection of the pervasiveness of the so-called claims made plan.

Specific cases. One of my members, a nonmanufacturer, experienced a rate increase of 900 percent despite his company's 75-year claims free history. The president of that company was in the process of buying the business across the street from him, financing the expansion out of retained earnings. Needless to say, he now has no retained earnings. His expansion plans are off, and he has been forced to finance his insurance premium at a rate of 14 percent.

Another member, a chemical specialties manufacturer, paid 300 percent more for less coverage than last year and was still unable to obtain any coverage for one-third of the company's products. The company has decided to go bare on those lines.

A third member managed to contain his rate increase to only about 300 percent by getting out of a whole line of business. That decision made it easier to finance his insurance costs. However, he was able to sell off some equipment in order to pay his premium.

I have horror stories galore, and I wish we had the time to discuss them all with you more specifically. I also wish that I could have produced a few small business people from the Cleveland area to speak for themselves, but my members in the midst of this crisis have an interesting additional problem. They are virtually all suppliers to major manufacturers, major retailers, or other large institutions. Those major customers have notified my members that they won't be doing business with supplier companies which are uninsured or underinsured. That is a way, I am sure, for the larger companies to limit their own exposure to liability, but it is hardly conducive to open public discussion of this volatile issue.

This problem is terribly pervasive. It cuts across industry lines, affecting manufacturing, retailing, and professional service companies alike. Companies in the direst straits are our youngest ventures, the most energetic job creators in our economy. Coverage is virtually unavailable to any company in business for 3 years or less.

The crisis is also as complex as it is widespread. High rates, of course, are only a symptom. The total problem involves a morass of societal, industrial, and management factors. To oversimplify, I would like to point to three issues.

The first and least serious, in my opinion, is the contention that small companies are sloppy in adhering to standards and practices which could assist them in limiting their liability. While that contention may be somewhat applicable for manufacturers, and especially for those who innovate, it simply cannot be a problem for the 75 percent of my members who are not manufacturers.

Smaller companies are no more inherently risky than large ones and neither more nor less irresponsible. In fact, I could probably make a pretty good intellectual case that given the limited products and services they provide and the limited markets they serve and the highly proprietary attitude toward their customers and their employees, smaller companies are inherently less risky than larger ones.

The second problem, the one most commonly discussed, is the increasing litigious nature of our society. This problem is partially society's fault, of course, but it is also a problem of national policy or, rather, the lack of policy. In the absence of clearly defined statute which codifies both companies' responsibilities for product and other liability and the public's right to recover damages, the courts must do the dirty work through the tort system. If this Congress could develop the courage to enact meaningful product liability reform at the national level, both plaintiffs and plaintiffs' counsel would have a whole lot less to do.

In my personal opinion, however, the single most important problem is the lack of adequate controls over the insurance industry. Standard States' rights policies of regulation at the State level are simply inadequate at a time when interstate and international commerce is the rule. State insurance departments are inadequate to do the job. Laws and technologies are changing too fast.

This special protected status of the insurance industry has enabled it to forget what business it is supposed to be in. State laws permitted insurance carriers in the seventies to buy cash at low prices and invest it at high rates of return. When interest rates dropped before many of these investments matured, insurance companies found themselves under-reserved to handle the claims that the early eighties produced.

Now, State law has permitted the insurance industry to pass the cost of its collective bad management decisions back to the marketplace wholesale, a practice which my members find abhorrent. After all, if a small company makes a pricing mistake or willfully underprices his product to buy business, he will end up either out of business or in jail or both.

Inadequate State law has also permitted the insurance industry virtually in total to turn its back on whole segments of industry by either refusing to insure certain lines or by setting premiums prohibitively high. What lines? Only the riskiest, of course, and those most likely to need insurance. And in a time of relatively high risk and relatively low capacity, companies will generally consolidate their limited capacity starting at the top of the market with their largest, easiest to manage, and most attractive customers. That is how the market works, and I suppose it is fair in a dog-eat-dog sort of way, unless you are one of my members in a claims free, 75-year-old company.

All these causes are very large, sweeping, and complex, of course, and their ultimate long-term solution will probably come too late for many of my members. In the shorter term, we must stop the bleeding, and here are some steps I suggest.

The first solution the Congress may not even need to act upon. Organizations like mine need to develop ways to combine the buying power of our members to give them more power in the marketplace. Many single industry associations have been able to take advantage of relaxed Federal regulation to create nonprofit service programs which can insure members against liability at lower than average costs. Such combines have the combined attractiveness of large size and administrative simplicity, features which insurers find attractive.

Groups like COSE, however, because of our heterogeneous membership, find organizing such programs legally complex and administratively expensive. We began exploration of this option a couple of months ago, and, if we do great homework. are extremely lucky, and if the bureaucracy works better than it usually does, we may have a program within 2 years. We need some help with that problem now.

The second step is tougher. We need to put a temporary chill on the court system to discourage outlandish jury awards. California's decision to limit punitive damage awards to $250,000 is an unattractive alternative, and I have heard all the arguments against it, but it may be a necessary step at the national level.

The best answer, of course, is the toughest: the establishment of tough national standards for product and other liability, standards which spell out both the plaintiff's right to sue for redress under certain conditions, and which provide manufacturers, distributors, retailers, and others with reasonable defenses for state-of-the-art design, a reasonable statute of limitations, and the intentional or negligent modification of a product postmanufacture.

The long-term answer, of course, lies partly with stronger guidelines for the insurance industry at the national level. This need not involve only more punitive regulation, although increased regulation and some basic changes in tax law will probably be necessary. But perhaps the industry could be encouraged through similar changes in the law to enact innovative programs to manage risk more effectively, to establish jointly pools to insure assigned risks, and to work at the State and local level with associations like mine to provide new and better services to the broad community.

My members would like to see the insurance industry reminded of what their customers invest their funds with them to do, not to diversify into banking, real estate, retailing, or other enterprises, but to assess and manage risk and to provide fair compensation to injured parties.

Now, perhaps it is fair to assume that the industry made a collective mistake by undervaluing its product under competitive pressures a few years ago. And perhaps it is therefore fair is some cosmic view that my members, who for years were the unwitting beneficiaries of the insurance industry's mistakes, should now be required to pay the real price. But I fear that with this body's inaction, we may choose simply to dismiss this current crisis as just another business cycle and set ourselves up for similar mistakes in the future. That would be a tragedy if it occurs, especially for those of my member companies for whom this issue is a matter of life or death today.

Thank you.

[The prepared statement of Mr. Polk follows:]

STATEMENT OF JOHN J. POLK, EXECUTIVE DIRECTOR, COUNCIL OF SMALLER ENTERPRISES

GOOD MORNING, MR. CHAIRMAN, AND MEMBERS OF THE COMMITTEE. MY NAME IS JOHN POLK, AND I'M HERE TODAY REPRESENTING SMALL BUSINESS UNITED. IN REAL LIFE, OUTSIDE OF WASHINGTON, I'M THE EXECUTIVE DIRECTOR OF THE COUNCIL OF SMALLER ENTERPRISES (COSE), THE SMALL BUSINESS DIVISION OF THE GREATER CLEVELAND GROWTH ASSOCIATION, CLEVELAND'S CHAMBER OF COMMERCE. COSE IS THE NATION'S LARGEST LOCAL SMALL BUSINESS GROUP, WITH 7,000 MEMBER COMPANIES EMPLOYING 150,000 GREATER CLEVELANDERS.

AMONG THE SERVICES WHICH COSE OFFERS ITS MEMBER COMPANIES IS PARTICIPATION IN ONE OF THE NATION'S LARGEST GROUP HEALTH CARE PLANS, PROGRAMS WHICH ARE SUBSTANTIALLY LOWER IN COST THAN SIMILAR PROGRAMS OUTSIDE OF COSE. BECAUSE OF THE SIZE AND SUCCESS OF THESE PROGRAMS, OUR MEMBERS ARE QUITE USED TO TURNING TO COSE FOR THEIR INSURANCE NEEDS. AND IT'S IN THAT CONTEXT THAT I FIRST BECAME PERSONALLY AWARE OF THE NATURE OF THE SIE AND SCOPE OF THE CURRENT CRISIS.

IN JULY OF LAST YEAR, I BEGAN TO RECEIVE CALLS FROM MEMBERS, BOTH BUSINESSPEOPLE THEMSELVES AND THEIR PROFESSIONAL ADVISORS, ASKING IF THERE WAS ANY WAY COSE COULD ASSIST MEMBERS IN OBTAINING LIABILITY INSURANCE AT MORE REASONABLE COSTS. I HADN'T RECEIVED A SINGLE CALL ON THIS SUBJECT FOR ABOUT FIVE YEARS, SO I INITIALLY CONSIDERED MY MEMBERS' PROBLEMS TO BE SYMPTOMATIC OF THE LATEST CYCLE IN THE INSURANCE BUSINESS, WHICH IS A PRETTY CYCLICAL INDUSTRY.

BY THE FALL, THOUGH, THE NUMBER OF CALLS WE RECEIVED ON THE PROBLEMS AND THE SENSE OF URGENCY EXPRESSED BY MEMBERS, HAD INCREASED BEYOND EXPECTED LEVELS, AND INDICATED THAT SOMETHING MORE SERIOUS THAN THE LATEST BUSINESS CYCLE WAS AT WORK. WE'RE NOW RECEIVING A STEADY COUPLE DOZEN CALLS A WEEK ON THE PROBLEM NOW.

I'VE BEEN TOLD BEFORE BY MEMBERS OF CONGRESS THAT THE FACT THAT SOME PEOPLE ARE EXPERIENCING PROBLEMS DOESN'T NECESSARILY MEAN THAT A PROBLEM EXISTS. SO OVER THE PAST COUPLE WEEKS I'VE SPOKEN WITH THE

35 MEMBERS OF MY BOARD OF DIRECTORS TO SEE HOW WIDESPREAD THE PROBLEMS REALLY ARE. THESE DIRECTORS ARE FROM EVERY SEGMENT OF INDUSTRY, AND THEIR COMPANIES RANGE IN SIZE FROM SOLE PRACTITIONERS TO A COUPLE OF HUNDRED EMPLOYEES.

OF MY 35 DIRECTORS, ALL BUT THREE REPORTED PREMIUM INCREASES OF AT LEAST 100% (TWO OF THOSE WERE IN THE FINAL YEAR OF A THREE-YEAR CONTRACT). AVERAGE RATES OF INCREASE WERE BETWEEN 300 AND 500 PERCENT. AND VIRTUALLY TO A COMPANY, THOSE INCREASES IN PREMIUM BOUGHT A LOWER LEVEL OF AVERAGE, A REFLECTION OF THE PERSUASIVENESS OF THE NEW "CLAIMS MADE" PLANS.

SPECIFICS? ONE OF MY MEMBERS, A NON-MANUFACTURER, EXPERIENCED A RATE INCREASE OF 900%, DESPITE HIS COMPANY'S 75-YEAR CLAIMS-FREE HISTORY. THE PRESIDENT OF THE COMPANY WAS IN THE PROCESS OF BUYING THE BUSINESS ACROSS THE STREET FROM HIM, FINANCING THE EXPANSION OUT OF RETAINED EARNINGS. HE NOW HAS NO RETAINED EARNINGS, HIS PLANS ARE OFF.

ANOTHER MEMBER, A CHEMICAL SPECIALITIES MANUFACTURER, PAID 300% MORE FOR LESS COVERAGE THAN LAST YEAR, AND WAS STILL UNABLE TO OPTAIN ANY COVERAGE ON ONE-THIRD OF THE COMPANY'S PRODUCTS. THE COMPANY HAS DECIDED TO "GO BARE" ON THOSE LINES.

A THIRED MEMBER MANAGED TO CONTAIN HIS RATE TO "ONLY" ABOUT 300% BY GETTING OUT OF A WHOLE LINE OF BUSINESS. THE DECISION MADE IT EASIER TO FINANCE HIS INSURANCE COSTS; HE WAS ABLE TO SELL OFF SOME EQUIPMENT TO PAY HIS PREMIUM.

I'VE GOT HORROR STORIES GALORE, AND I WISH I COULD DISCUSS THEM MORE SPECIFICALLY. I ALSO WISH I COULD HAVE PRODUCED A FEW SMALL BUSINESS PEOPLE TO SPEAK FOR THEMSELVES, BUT MY MEMBERS, IN THE MIDST OF THIS CRISIS, HAVE AN ADDITIONAL PROBLEM: THEY ARE VIRTUALLY ALL SUPPLIERS TO MAJOR MANUFACTURERS, RETAILERS, OR INSTITUTIONS. AND THOSE MAJOR CUSTOMERS HAVE NOTIFIED MY MEMBERS THAT MAJOR CUSTOMERS

WON'T BE DOING BUSINESS WITH COMPANIES WHICH ARE UNINSURED OR UNDERINSURED. A WAY, I'M SURE, FOR THE BIGGER COMPANIES TO LIMIT THEIR OWN EXPOSURE. BUT HARDLY CONDUCIVE TO OPEN PUBLIC DISCUSSION ON A VOLATILE ISSUE.

THIS PROBLEM IS TERRIBLY PERVASIVE. IT CUTS ACROSS INDUSTRY LINES, AFFECTING MANUFACTURING, RETAIL, AND PROFESSIONAL SERVICE COMPANIES ALIKE. COMPANIES IN THE DIREST STRAITS ARE OUR YOUNGEST VENTURES: COVERAGE IS VIRTUALLY UNAVAILABLE TO COMPANIES IN BUSINESS FOR THREE YEARS OR LESS.

THIS CRISIS IS ALSO AS COMPLEX AS IT IS WIDESPREAD. HIGH RATES ARE, OF COURSE, MERELY A SYMPTOM. THE TOTAL PROBLEM INVOLVES A MORASS OF SOCIETAL, INDUSTRIAL, AND MANAGEMENT FACTORS. TO OVERSIMPLIFY, HOWEVER, I'D LIKE TO POINT TO THREE ISSUES.

THE FIRST, AND LEAST SERIOUS OF THESE ISSUES, IS THE CONTENTION THAT SMALL COMPANIES ARE SLOPPY IN ADHERING TO STANDARDS AND PRACTICES WHICH COULD ASSIST THEM IN LIMITING THEIR LIABILITY. WHILE THIS MAY BE TRUE FOR MANUFACTURERS, ESPECIALLY THOSE WHO INNOVATE, IT SIMPLY CANNOT BE A PROBLEM FOR THE 75% OF MY MEMBERS WHO ARE NOT MANUFACTURERS. SMALLER COMPANIES ARE NO MORE INHERENTLY RISKY THAN LARGE ONES, GENERALLY SPEAKING, AND NEITHER MORE NOR LESS IRRESPONSIBLE. IN FACT, I COULD PROBABLY MAKE A PRETTY GOOD INTELLECTUAL CASE THAT, GIVEN THE LIMITED NUMBER OF PRODUCTS AND SERVICES THEY OFFER AND THE LIMITED MARKETS THEY SERVE, TOGETHER WITH A MUCH MORE PROPRIETARY ATTITUDE TOWARD THEIR EMPLOYEES AND CUSTOMERS, SMALL COMPANIES ARE INHERENTLY LESS RISKY THAN LARGE ONES, AND CONSEQUENTLY MUCH LESS EXPOSED TO THE POTENTIAL FOR ENORMOUS LIABILITY.

THE SECOND PROBLEM, AND THE ONE MOST COMMONLY DISCUSSED, IS THE INCREASINGLY LITIGIOUS NATURE OF OUR SOCIETY. THIS PROBLEM IS PARTIALLY SOCIETY'S FAULT, AND PARTLY THE FAULT OF NATIONAL POLICY, OR LACK OF

POLICY. WE CAN BLAME PEOPLE FOR BEING PEOPLE, AND WISHING TO OBTAIN THROUGH THE COURTS MAXIMUM REDRESS OF GRIEVANCES BOTH REAL AND IMAGINARY, AND WE CAN BLAME THE LAWYERS FOR ENCOURAGING PEOPLE TO DO SO. BUT THE FACT IS THAT IN THE ABSENCE OF CLEARLY DEFINED STATUTE WHICH CODIFIES BOTH COMPANIES RESPONSIBILITIES FOR PRODUCT AND OTHER LIABILITY, AND THE PUBLIC'S RIGHTS TO RECOVER DAMAGES, THE COURTS MUST DO THE DIRTY WORK THROUGH THE TORT SYSTEM. IF THE CONGRESS COULD DEVELOP THE COURAGE TO ENACT MEANINGFUL PRODUCT LIABILITY REFORM AT THE NATIONAL LEVEL, BOTH PLAINTIFFS AND PLAINTIFFS' COUNSEL WOULD HAVE A WHOLE LOT LESS TO DO.

IN MY PERSONAL OPINION, THE SINGLE MOST IMPORTANT PROBLEM, HOWEVER, IS THE LACK OF ADEQUATE CONTROLS OVER THE INSURANCE INDUSTRY. STANDARD STATES' RIGHTS POLICIES OF REGULATION AT THE STATE LEVEL ARE INADEQUATE IN A TIME WHEN INTERSTATE-AND INTERNATIONAL-COMMERCE IS THE RULE. STATE INSURANCE DEPARTMENTS ARE INADEQUATE TO DO THE JOB; LAWS AND TECHNOLOGIES ARE CHANGING TOO FAST. THE SPECIAL PROTECTED STATUS OF OUR INSURANCE INDUSTRY HAS ENABLED IT TO FORGET THE BUSINESS IT'S SUPPOSEDLY IN. STATE LAWS PERMITTED INSURANCE CARRIERS IN THE SEVENTIES TO BUY CASH AT LOW PRICES AND INVEST IT AT HIGH RATES OF RETURN. WHEN INTEREST RATES DROPPED BEFORE MANY OF THESE INVESTMENTS MATURED, INSURANCE COMPANIES FOUND THEMSELVES UNDER-RESERVED TO HANDLE THE CLAIMS THE EARLY TO MID-EIGHTIES PRODUCED. NOW STATE LAW HAS PERMITTED THE INDUSTRY TO PASS THE COST OF ITS COLLECTIVE BAD MANAGEMENT DECISIONS BACK TO THE MARKETPLACE WHOLESALE, A PRACTICE WHICH MY MEMBERS FIND ABHORRENT. AFTER ALL, IF A SMALL COMPANY MAKES A PRICING MISTAKE, OR WILLFULLY UNDERPRICES HIS PRODUCT TO BUY BUSINESS, HE'LL GENERALLY END UP OUT OF BUSINESS, OR IN JAIL, OR BOTH.

INADEQUATE STATE LAW HAS ALSO PERMITTED THE INDUSTRY VIRTUALLY IN TOTAL TO TURN ITS BACK ON WHOLE SEGMENTS OF INDUSTRY, BY EITHER REFUSING TO INSURE CERTAIN LINES OR BY SETTING PREMIUMS PROHIBITIVELY HIGH. WHAT LINES? ONLY THE RISKIEST, OF COURSE, THOSE MOST LIKELY TO NEED INSURANCE. AND IN A TIME OF RELATIVELY HIGH RISK AND RELATIVELY LOW CAPACITY, COMPANIES WILL GENERALLY CONSOLIDATE THEIR LIMITED CAPACITY STARTING AT THE TOP, WITH THEIR LARGEST, EASIEST TO MANAGE, AND MOST ATTRACTIVE CUSTOMERS. THAT'S HOW THE MARKET WORKS, AND IT'S FAIR, IN A DOG-EAT-DOG WAY. UNLESS YOU'RE ONE OF MY MEMBERS IN A CLAIMS-FREE, 75-YEAR-OLD COMPANY.

ALL OF THESE CAUSES ARE VERY LARGE, SWEEPING AND COMPLEX, AND THEIR ULTIMATE LONG-TERM SOLUTION WILL PROBABLY COME TOO LATE FOR SOME OF MY MEMBERS. IN THE SHORTER TERM, WE MUST STOP THE BLEEDING. HERE ARE SOME STEPS I SUGGEST:

THE FIRST SOLUTION THE CONGRESS MAY NOT EVEN NEED TO ACT ON: SMALLER ORGANIZATIONS LIKE MINE NEED TO DEVELOP WAYS TO COMBINE THE BUYING POWER OF OUR MEMBERS TO GIVE THEM MORE POWER IN THE MARKETPLACE. MANY SINGLE-INDUSTRY ASSOCIATIONS HAVE TAKEN ADVANTAGE OF RELAXED FEDERAL REGULATION TO CREATE NON-PROFIT SERVICE PROGRAMS WHICH CAN ENSURE MEMBERS AGAINST LIABILITY AT LOWER-THAN-AVERAGE COSTS. SUCH COMBINES HAVE THE COMBINED ATTRACTIVENESS OF LARGE SIZE AND ADMINISTRATIVE SIMPLICITY-FEATURES WHICH INSURERS FIND ATTRACTIVE. GROUPS LIKE COSE, BECAUSE OF OUR HETEROGENEOUS MEMBERSHIP, FIND ORGANIZING SUCH PROGRAMS LEGALLY COMPLEX AND ADMINISTRATIVELY EXPENSIVE. WE BEGAN EXPLORATION OF THIS OPTION A COUPLE MONTHS AGO, AND IF WE DO GREAT HOMEWORK, ARE VERY LUCKY, AND THE BUREAUCRACY WORKS BETTER THAN IT USUALLY DOES, WE MAY HAVE A PROGRAM WITHIN TWO YEARS. WE COULD USE SOME HELP.

THE SECOND STEP IS TOUGHER: WE NEED TO PUT A CHILL ON OUR COURT SYSTEM, TO DISCOURAGE OUTLANDISH JURY AWARDS. CALIFORNIA'S DECISION TO LIMIT PUNITIVE DAMAGE AWARDS TO $250,000 IS AN INATTRACTIVE ALTERNATIVE, AND I'VE HEARD ALL THE ARGUMENTS AGAINST IT, BUT IT MAY BE A NECESSARY STEP AT THE NATIONAL LEVEL. A SHORT-TERM MORATORIUM ON AWARDS IN EXCESS OF THAT AMOUNT WOULD HAVE SEVERAL RESULTS: IT WOULD ENCOURAGE SETTLEMENTS OF EXISTING LITIGATION BEFORE THE MORATORIUM TOOK EFFECT, IT WOULD CAP THE MAXIMUM AWARD FOR NON-ECONOMIC DAMAGE, THUS REMOVING A MAJOR INCENTIVE TO PURSUE LENGTHY AND OFTEN FRIVOLOUS LITIGATION ON A CONTINGENCY BASIS, AND IT WOULD RESTORE A MEASURE OF PREDICTABILITY TO THE POTENTIAL LIABILITY TO WHICH COMPANIES AND THEIR INSURANCE CARRIERS ARE EXPOSED.

THE BEST ANSWER IS THE TOUGHEST, OF COURSE: ESTABLISHMENT OF TOUGH NATIONAL STANDARDS FOR PRODUCT AND OTHER LIABILITY. STANDARDS WHICH SPELL OUT BOTH THE PLAINTIFF'S RIGHT TO SUE FOR REDRESS UNDER CERTAIN CONDITIONS, AND WHICH PROVIDE MANUFACTURERS, DISTRIBUTERS, RETAILERS AND OTHERS WITH REASONABLE DEFENSES FOR STATE OF THE ART DESIGN, A REASONABLE STATUE OF LIMITATIONS, AND THE INTENTIONAL OR NEGLIGENT MODIFICATION OF A PRODUCT.

THE LONG-TERM ANSWER, I FEAR, LIES WITH STRONGER GUIDELINES FOR THE INSURANCE INDUSTRY AT THE NATIONAL LEVEL. THIS NEED NOT INVOLVE ONLY MORE PUNITIVE REGULATION, ALTHOUGH INCREASED REGULATION AND SOME BASIC CHANGES IN TAX LAW MAY BE NECESSARY. BUT PERHAPS THE INDUSTRY COULD BE ENCOURAGED THROUGH SIMILAR CHANGES TO ENACT INNOVATIVE PROGRAMS TO MANAGE RISK MORE EFFECTIVELY, TO ESTABLISH JOINTLY POOLS TO INSURE

ASSIGNED RISKS, TO WORK WITH ASSOCIATIONS LIKE MINE TO PROVIDE NEW AND BETTER SERVICES TO THE BROAD COMMUNITY. SPEAKING PERSONALLY, I'D LIKE TO SEE THE INSURANCE INDUSTRY REMEMBER WHAT MY MEMBERS, THEIR CUSTOMERS, INVEST THEIR FUNDS WITH THEM TO DO: NOT DIVERSIFY INTO BANKING, REAL ESTATE, RETAILING OR OTHER ENTERPRISES, BUT TO ASSESS AND MANAGE RISK, AND PROVIDE FAIR COMPENSATION TO INJURED PARTIES. PERHAPS IT'S FAIR TO ASSUME THAT THE INDUSTRY MADE A MISTAKE BY UNDER-VALUING ITS PRODUCT A FEW YEARS AGO. AND PERHAPS IT'S THEREFORE FAIR, IN THE COSMIC VIEW, THAT MY MEMBERS, WHO FOR THOSE YEARS WERE THE UNWITTING BENEFICIARIES OF THE INDUSTRY'S MISTAKEN LARGESSE, SHOULD NOW BE REQUIRED TO PAY THE REAL PRICE. BUT I FEAR THAT, WITH THIS BODY'S INACTION, WE MAY CHOOSE TO DISMISS THIS CURRENT CRISIS AS JUST ANOTHER BUSINESS CYCLE, AND SET OURSELVES FOR SIMILAR MISTAKES IN THE FUTURE. IT WILL BE A TRAGEDY IF THAT OCCURS, ESPECIALLY FOR ALL THOSE COMPANIES FOR WHOM THIS IS A MATTER OF LIFE OR DEATH TODAY.

Senator **BUMPERS**. Gentlemen, thank you all very much for your testimony.

Let me just start with Mr. Zehnder on one thing. On page 3 of your testimony, Mr. Zehnder, you say that 69 percent of the respondants reported increases in liquor liability premiums during the previous year although 91 percent said they had never been named in a suit, and the average increase was 110 percent. Then, on the next page, on page 4, you say the insurance companies are sympathetic to your plight.

How do you consider the insurance companies sympathetic to you when you say 91 percent of these people never filed a claim and yet they are still socking you with 110 percent increases?

Mr. **ZEHNDER**. Well, I think that they are sympathetic in saying that it is not our fault; it is the judicial system that is causing some of the difficulties. And we had 20 companies try to bid on our umbrella policy this year, and we ended up with 3. The other 20 said they don't want anything to do with it. Three of them bid it, and we have the lowest of the three, and it was a 2,000 percent increase.

Senator **BUMPERS**. How do you justify that kind of an increase considering the fact that 91 percent of these people never had a claim filed against them.

Mr. **ZEHNDER**. I can't. It just doesn't make sense.

Senator **BUMPERS**. I think we have a double problem here. I think we have probably a problem with the tort system, and I think there are some things that probably need to be changed about it, but testimony such as yours here this morning which is very illuminating would indicate that there may be some companies simply taking advantage of the herd instinct in this country and that is to get on the bandwagon and charge excessive rates.

On the other hand, insurance companies, my own insurance broker—I was trying to buy liability insurance for my 23-year-old daughter, and he said they don't even want the business.

Mr. ZEHNDER. That is what most of them have indicated.

Senator BUMPERS. That is what we have heard here for the last 2 days. Look, if you want to pay this premium, fine, but we would just as soon not write it at all.

Mr. ZEHNDER. Exactly.

Senator BUMPERS. What do you think, all of you gentlemen, would be the reaction of the insurance companies if the Government or, say, the Small Business Committee, decided to introduce and write a bill establishing a national insurance pool for small business of all kinds? What do you think their reaction would be?

Mr. POLK. I guess I will start the ball rolling. It is difficult, I think, for most small business people instinctively to express violent need for some kind of national regulation or for the formation of some kind of new bureaucracy at the Federal level. It may be possible, I think, to work more effectively with insurance companies in a cooperative way to establish legislation with which the industry could agree that would establish some kind of meaningful forum for the discussion of these kinds of issues.

I think that simply making the leap of faith into the formation of a national insurance pool may sell the integrity of the industry itself short. After all, these guys are only doing what the law permits them to do.

Senator BUMPERS. The reason I ask the question is because I consider this a crisis of considerable magnitude for small business. The bigger the business, the easier time they have passing this on. The smaller the business, the more difficulty they have passing these premium costs on.

We have an employer in Hebrew Springs, AR, Jim, which makes concrete buckets, big concrete buckets like you see on high rise buildings that they lift concrete to the top on a boom with. He says—we were on a plane together the other night—he says 7 cents out of every dollar he takes in is now going for liability insurance, and he has had one claim in the past 12 years. He got his coverage cut from $6 million to $1.5 million and his premium quadrupled. I thought that was outrageous until the last 2 days. That looks like a bargain compared to what some of these people are saying.

Mr. LIENHART. Senator, I think in Arkansas in the assigned risk pool the rates are so much higher in the pool than if you went out and tried to bid on the insurance, I think the insurance companies would like it. A lot of the people who are getting insurance written on buses are paying $7,000 or $8,000 per bus per year, and the pool coverage is $13,000. They like it.

Of course, a lot of it depends on the price a commission—or the kind of rate they would set up what it would cost. But I would think in Arkansas they like to get in the pool.

Senator **Bumpers**. One of the things that concerns me here, and, Mr. Zehnder, you sort of fortified this as I sat and listened in hearings yesterday, and that is they are not making any distinction between industries. There is a distinction, but it is a very refined one. They are not making any distinction between loss records of the past, between certain industries, and between certain States. I don't mind telling you I take exception to rates being increased in Arkansas because they tell me they are paying big jury verdicts in California.

Mr. **Lienhart**. That is right.

Senator **Bumpers**. You know, I am not responsible for the fact that California's law may permit these exorbitant jury verdicts. Somebody said yesterday that product liability jury verdicts had gone from $800,000 average in 1975 to $1.8 million in 1985. I can tell you, and I haven't kept up with it in years, I used to be a trial lawyer. But I can tell you there have been 10 cases in the last 10 years in Arkansas where a jury verdict exceeded $1 million.

So, I don't know where these big verdicts are. Surely, they are not all in California, but I can tell you they are not in Arkansas. And I resent the fact that my people are being asked to pay these exorbitant rates because other States apparently have much more liberal liability laws than we do.

Finally, let me just say that it seems to me that this idea of contingency fees—everybody has hit on that. I don't know right now precisely how to address that. There was a statement made here yesterday by a gentleman from the American Trial Lawyers Association. He read headlines about how there was a massive insurance crisis, premiums are being quadrupled and so on, and after he got through—and we just assumed that was the Flint, MI, daily, Carl—and when he got through, it turned out it was a newspaper in Ottawa, Canada. And Canada is going through the same crisis we are, and yet product liability there has been limited to $50,000 per case since 1962 and attorney fees may not exceed, I believe, 25 percent, or maybe there is no contingency fee allowed in Canada.

So, that makes you wonder. You can't just ignore things like that, but I will say this. Right now, the law is—and you gentlemen have all testified on this matter of contingency fees which trial lawyers consider sacred—but it seems to me, and I have voted here consistently for laws where the Government sues a taxpayer—it is what we call equal access to justice—if the Government sues a taxpayer and loses, that taxpayer gets his attorney fees. I think that is a good law. I think if you can take on the U.S. Government and win, you are certainly entitled to attorney fees.

Right now, under Federal law and under most State laws, the defendant who prevails is also entitled to attorney fees. But bear in mind, courts don't like frivolous lawsuits any better than you gentlemen do. I have been in a lot of courts, and I have seen judges just consistently tear people up saying what do you mean by bringing that case in here; that doesn't have any merit.

Of course, we are inundated in my State with inmate petitions. I have been trying to do something about inmate petitions, because about 98 percent of them are frivolous. I don't want to deny anybody their civil rights and all that sort of thing, but yet we know that 98 percent of those things are frivolous, and the courts don't like frivolous lawsuits either.

It seems to me that defense counsel in this country are probably not pursuing aggressively that very point. If courts awarded defense attorney fees more often, you would stop a lot of frivolous lawsuits from being filed. So, I think that point is well taken.

One other point I might make and that is, are the insurance regulators in your respective States involved in this? Incidentally, Mr. Polk, my sister has been very active in COSE.

Mr. **Polk**. She, as a matter of fact, asked that we bid good morning to her handsome and smarter younger brother.

Senator **Levin**. How many younger brothers does she have?

Senator **Bumpers**. She got the money in our family, and turned Republican just as soon as she made her first million.

Mr. **Green**. Senator Bumpers, in Oklahoma, we were very involved with the State regulatory board, the State insurance agency. They helped us get insurance at the last moment, and we appreciated that. Of course, I threatened to give our 5,000 customers the gentleman's home telephone number as well as the Governor's telephone number, but I don't think we would have had insurance if the State agency hadn't helped us push the insurance companies to do something.

Senator **Levin**. That threat of yours tended to focus their mind a bit on the problem, I take it. The 5,000 calls to the Governor tended to focus their minds a bit?

Mr. **Green**. I don't think it did, but I threatened it.

Mr. **Polk**. In the State of Ohio, the commissioner of the department of insurance is a political appointee. He does have some background in the insurance industry, but it is essentially a patronage appointment.

The situation in Ohio is complicated by some recent judicial messing around with our workers' compensation system which has left many companies simply uninsurable for liability for injuries which occur on the job. So, we haven't really gotten around to the issue of general business liability insurance too much yet.

The difficulty, though, is simply that with so many insurance companies writing so many different kinds of policies in the State of Ohio, our State insurance department, which is composed of 16 insurance regulators, last year attempted to evaluate some 6,000 changes in insurance rating formulas. That is impossible to do.

Senator **Bumpers**. I think you are probably right. The States simply don't have the resources to address that. But I must say one of my concerns—my primary concern is the survival of small business, and a lot of them simply are not going to be able to survive because they can't pass these exorbitant increases on.

Mr. **Polk**. Senator, in the area of national product liability pools, I wonder if you might consider a different tack.

Senator **Bumpers**. I just threw that out. I am not considering that. I just threw that out for speculation, because the point is I personally believe the insurance companies would squeal like a pig under a gate if such a proposal were made here.

Mr. **Polk**. The banks have been persuaded for many years to live under the onus of the Community Reinvestment Act, a piece of national legislation which mandates that banks which do business in communities make certain business reinvestments back in the communities for projects such as housing, education, and other issues that are worthy of the banks' participation.

I think that similar legislation, a Community Reinvestment Act-type bill which forced insurance companies at the State and local levels to make innovative new investments or develop innovative new programs at the State and local levels in exchange for some incentives, either positive or negative, may have an impact on the availability of certain kinds of insurance at the neighborhood level. In some cases, as you know, cities and townships and neighborhoods are simply being redlined out of the business because the industry is permitted selective to insure.

Some kind of action which forced some accountability at the State and local levels might be a partial solution to the problem in the long run.

Senator BUMPERS. Gentlemen, let me just say that I suppose that Congress—if this problem is not alleviated soon—will take some action, maybe in the form of a Danforth bill or something else. But I personally always am most reluctant for the Congress to get the Federal Government involved in yet another problem that really is legitimately the province of the States.

Now, we are constantly being called on here to address things that the States ought to be addressing. When we do get involved, it ought to be with great reluctance and under extreme circumstances where it cannot be regulated or handled at the State level. Perhaps this is going to be such a case, but I must say that I am always hesitant for the Government to get involved in still one more thing.

After all, that is what Ronald Reagan came to power for, was to get the Government's tentacles out of everybody's business.

Senator Kasten, I am going to have to leave. Are you going to be here?

Senator KASTEN. Senator Pressler said he was going to be back at 10:30. I was going to leave at 10:30, but we can work this out somehow.

Senator BUMPERS. OK. I have to run to an Energy Committee meeting. If you could take over for a few minutes, and if he is not back, I will return.

Senator KASTEN [acting chairman]. OK, thank you.

I would like to just continue on this basic States' rights approach. Do you know, Mr. Polk, of your members with their problems with product liability how many of these people are selling their products in Ohio only—you are from Cleveland, OH—as opposed to how many people are selling their products around the country?

Mr. POLK. I would venture to say that particularly in the area of manufacturing the vast majority of my members do business across State lines. Certainly, they serve as suppliers to major corporate customers which sell around the country and around the world.

I would also like to point out that while product liability is an important concern, this particular crisis, general liability insurance, has no respect for industrial lines. White collar companies, lawyers, accountants, certainly physicians, just about anybody who is in business at any level in any industry is experiencing a similar crisis.

Senator KASTEN. Let me just talk about the products part of it for a moment more. We also, like Arkansas, in Wisconsin, we haven't had some of these outrageous kinds of settlements that they have had in other States, including California. But my Wisconsin manufacturer can't be sure if he is going to be in court in Wisconsin next month or if he is going to be in court in California next month or in Texas or New Jersey or in Arkansas.

He might prefer to be in court in one of these other States, but he doesn't have that choice. Therefore, it seems to me that a State-by-State solution simply won't work in terms of the products. Would you agree with me or would you disagree?

Mr. POLK. I think that a State-by-State level of regulation for the insurance industry generally, and certainly in the liability area, simply flies in the face of the way our economy works in the 20th century and on the threshold of the 21st. There aren't too many mom and pop stores doing business only in their neighborhoods any more. Interstate commerce is the name of the game today.

Senator KASTEN. As you or other gentlemen on the panel may be aware, in 1979 and 1980 in the Carter administration, there was an effort made by the Commerce Department to enact, if you will, a uniform product liability law. The idea was that the Commerce Department at the national level would develop the uniform product liability law and then it would be adopted by each of the 50 States. So, the States would have adopted a uniform law not unlike the uniform commercial code. The same basic theory can apply that a contract that you write in Ohio has to be enforceable in Ohio but also in my State of Wisconsin and in California and in Arkansas.

So, we have a uniform commercial code which sets a basic bottom line of understanding on how contract law will be. That doesn't prohibit contract questions from coming up in the courts, but we all know where we are starting from.

The previous administration tried to make this effort. What happened was that the trial lawyers came to each of the different States and opposed the law. Less than half of the States were able to adopt a law at all, and of the half that adopted a law, the trial lawyers lobbying within the State legislatures were able to jimmy them up so that they weren't able to have an effective law in most places. And where they did in fact have a law, they were inconsistent from one State to another.

So, we kept this kind of patchwork of efforts. So, it seems to me that now we are faced only with the concept of trying to work for some kind of a Federal product liability law, a Federal tort reform dealing with products, and that is the effort that I and others have been working on for a while.

Mr. Zehnder, you were talking about the insurance people before, but I don't mean to limit this to you, do you have any indication that the people who are insuring you who are increasing these premiums by 100 or 1,000 percent—we have heard wild percentages over the last couple of days—that these insurance people are making tremendous profits in liability insurance, that this is all of a sudden a great business to go into? Would you be ready to jump out of the restaurant business tomorrow and start a little insurance company because these are wonderful opportunities for capital and investment and for profits?

I don't have that indication. Do any of you have the indication that all of a sudden this is a wonderful place to be and these insurance premiums are increasing and there is a great chance here to make a lot of money?

Mr. **Zehnder**. I think if there were that chance here to make a lot of money, there would be a lot more people willing to bid on the insurance. Most of the companies say we don't want it. Go to somebody else. We would just as soon not be bothered with liquor liability insurance or in a business where there are a lot of people around. The risks are just too high.

Mr. **Polk**. I really believe personally, Senator, that what we are seeing here is not price gouging by any stretch of the imagination, although that is certainly the primary visible symptom. What we are seeing is the fallout of a lot of bad management decisions in the past. There is nobody making a whole lot of money off this right now. What is happening is that the industry has been permitted to recoup substantial losses which it incurred in the early part of this decade simply by being permitted to pass along wholesale rate increases.

The same thing has happened to us in the group insurance area. Unfortunately, there is in a business setting usually if a company makes a mistake on pricing its product and you have a contract with a customer of some kind, you are asked to kind of negotiate some sort of reasonable solution to the problem. Here, State legislatures or State regulators simply permit the insurance industry to pass their mistakes wholesale back to the marketplace with no control whatsoever.

Senator **Kasten**. Well, I think many people would agree that the insurance people were making money in the past on investments rather than on insurance. Now, they are in the process of having to break even on insurance which is changing some of it.

I also think that at least from your testimony and the testimony that we received yesterday and that we have received in other hearings that there is no question about the dramatic increase in litigation across this country. And in that litigation and in settlements that are prior to final litigation we are seeing a dramatic increase in awards, in punitive damages, in other kinds of areas which are very, very difficult to predict.

I think that a major factor has, without question, been the dramatic increase in litigation. Small business is also, I believe, facing an uncertain future with the situation that presently confronts us. And I think a solution of some kind is simply going to have to come from us here in Washington, particularly to help the kinds of instances we were talking about before.

Senator Levin.

Senator **Levin**. Thank you, Senator Kasten.

I want to join in welcoming all of you, particularly you, Mr. Zehnder, managing an extraordinary restaurant in an historic town. We are particularly glad to have you in Washington, even though we are sorry that you are here under these circumstances.

There is a crisis, obviously, for small business, and the question is what is the remedy, whether we are going to let the market try to find the remedy and provide it or whether government is going to have a role and, if so, whether it is at the Federal or State level.

The trend has been, I think as you gentlemen know, toward market solutions, not toward government imposed solutions. That is one of the trends that you are bucking by being here.

The second trend that you are bucking by being here is that where government is looked to for the solution, it is more and more State government rather than Federal Government. We are tending both to deregulate which means less government and also to defederalize or decentralize, more accurately, the use of the Federal system and rely more on State legislatures for solutions and State regulatory bodies.

So, you are kind of swimming upstream by being here. I am glad you are here, because I think there are government roles, government solutions that are required where the market fails, and I think there are Federal roles that are required where State governments are not adequately addressing a solution. I think you are aware of the fact that for both those reasons, you are taking on a massive chore here.

One question that I would like to ask of each of you, and one of you, I think, has already addressed this, is what relief have you both sought and achieved at the State level? Before the Federal Government gets involved, we obviously have to have a record of State government or regulatory agency failure to respond to a need. I would like to have perhaps each of you address that question.

What relief have you sought from your State legislature both on the insurance rate questions and on the tort law questions?

Mr. LIENHART. Senator, we haven't been able to do much with the State for the simple fact that we operate interstate. By interstate law, we are required to have $5 million worth of liability insurance. At the State level, all we are required to have is an absurdly little amount of $100,000. No one in their right mind is going to operate a busload of people with $100,000 of liability insurance.

So, we have a beef with the State in the fact that all we can get is what is required which is $100,000 which we can't run with and the $5 million that we can't afford. So, we are in a dilemma, and the only relief that we can see is to get relief from the $5 million, and that will have to come from the Federal Government.

The only thing the State has done is raise the rates when you go through an assigned risk pool, and that has hurt us a whole lot, but we haven't had any input as far as what those rates would be.

Senator Levin [acting chairman]. Mr. Green, I guess you are in a similar position in your business.

Mr. GREEN. Yes. The $5 million is what we need relief from. Within the State, $300,000 would be adequate protection by the State requirements.

We have tried in Oklahoma to just pass a House bill that last night got out of the House committee about doing something about the law so that the lawsuits might be controlled a little bit. But I think it is going to have a bumpy road ahead of it.

Senator LEVIN. Mr. Zehnder.

Mr. Zehnder. In 1985 is when the liquor liability really hit the Michigan area. All the restaurant owners and the bar operators went to the legislature and said this is the problem we have. Now, in 1986, it is not just liquor liability, but it is general liability, and there really has not been a lot of talk.

One of the problems, I think, like the Michigan Restaurant Association had is that their lobbying firm was also the same firm that had the trial lawyers, so they had to hire a new lobbying firm. So, that caused some difficulties.

I stay in Frankenmuth and operate a restaurant and try to keep abreast of things, but it is difficult for a small businessman to be totally involved in all the legal and the governmental things that are going on. I guess that is why we elect Senators and the House of Representatives. But I guess there is a lot of talk, and I just haven't seen much action on that whole issue in our State, and maybe that is why I am here today.

But I do believe that it should be a State problem, but it has to be handled within all the States, especially for a lot of restaurants that may be in the chain business where they have restaurants in different States or hotels that have hotels in different States. The liability and the liquor liability laws are different in a lot of those States and how do they cope with it. I wish the States would handle it, but so far, they haven't been doing much in Michigan.

Senator Levin. Mr. Polk, I think you have already addressed this.

Mr. Polk. Yes. In the State of Ohio, unlike with other States, there is no such thing as a State fund to provide insurance to assigned risks. The State of Ohio has traditionally taken a hands off attitude toward those kinds of issues.

Within the next month, I am told that no fewer than six bills will be introduced in the State's general assembly which address various aspects of this issue. Largely, those bills have to do with establishing advisory committees of various kinds, watchdog agencies which are, once again, sort of formalized bodies in which we are permitted to talk about problems but not do too much about them.

Senator Levin. Let me start with you, Mr. Polk, on the next question, and if anyone else wants to comment, do so.

The immunity or the qualified immunity for the insurance industry in Federal law, do you have any comment on that? Are you recommending we eliminate or change that modified immunity for the insurance industry?

Mr. Polk. While I am by no means a technician and can't comment on how current law, particularly tax law, affects insurance companies, it is very clear——

Senator Levin. I am talking about the antitrust laws.

Mr. Polk. It is very clear that a company whose life blood is managing other people's money probably needs to be substantially more accountable at the Federal level for things like application for rates of increase, justification in a national forum of changes in business practices that ignore wholesale segments of industry—those are issues that can only be dealt with, I believe, effectively at the national level.

Senator Levin. Does anyone else want to comment on the immunity which has been provided the insurance industry from Federal antitrust law?

[No response.]

Senator Levin. If you have a later comment for the record, feel free to let us have that. That is, obviously, a critical issue.

I think one of you has commented with an insurance pool within your own industry, and you have indicated, Mr. Polk, I think, the difficulty of doing it where you have, in your instance, such a variety of constituents that make up your particular organization.

Are there any other comments on that? Are there any other efforts made in the transportation or gas or restaurants to self-insure?

Mr. Zehnder. There was talk about 6 months ago, and we met a couple of times with an offshore type insurance company. It just seems a little un-American to be sending this money to the Bahamas, I believe, is where the insurance is actually located.

In looking at the legalities of putting it all together, the restaurants were too high a risk, and even the people who do that type of thing didn't want to be involved with the restaurants. They do it for some manufacturing concerns in Michigan. Bowling alleys are involved in it, I think, in Michigan, but right now we are looking at starting a whole new insurance company in Michigan.

Senator Levin. Just for restaurants?

Mr. Zehnder. No. There are 10 restaurants in it, and then you have to have a mixture of different companies. It cannot just be restaurants. It is very, very preliminary at this point. If there is all that money in insurance, maybe we should get part of it, but I don't think it is there.

Senator Levin. Mr. Green.

Mr. Green. The LP gas group discussed the offshore idea, but I don't think anyone really wanted to pursue it that badly. We have mentioned a State insurance pool. We might clarify that in Oklahoma and probably as well in Arkansas, the State pool means your vehicles can be covered. That doesn't have anything to do with product liability, and I believe the coverage is only $750,000 which is far short of the $5 million requirement.

Mr. Lienhart. In the seventies, one of the organizations that we belong to, United Bus Owners of America, tried to self-insure, but they had a problem with the reserves. They couldn't get enough reserves up from the different bus owners, and as soon as other insurance companies entered the market with cheaper prices, people left the program, and the program didn't exist anymore. That was the last time, I think, we have tried self-insurance as an organization, not just one bus company.

But there are bus companies which are petitioning the ICC for self-insurance for the $5 million. I don't know how it has come out, but I know it is pending.

Senator Levin. We had testimony yesterday that there is a study by the Rand Corp. which allegedly says that verdicts and settlements have gone up no faster than the rate of inflation for the last 15 years. I sort of glanced back at our staff back here. We weren't familiar with that study, but it is going to be furnished to the committee. If any of you are interested in that, assuming we get it, we are interested in it, because it certainly flies in the face of everything that we understand to be the facts, you might make inquiry with us and we will get you a copy of that information, because we would like to get your reaction to any allegations which are made in that study so we can have a complete record.

There is a crisis. It is hurting small business. This committee is deeply concerned about the impact on small business. The solutions are obviously complicated. It may be a mixture of governmental and market actions.

However, we are again delighted that you came here today. We are sorry that you had to be here today. We are sorry that you are not serving lunch in Frankenmuth today instead of having to eat in Washington. The food is a heck of a lot better in Frankenmuth, by the way.

We are going to recess until Senator Pressler gets back. Thank you.

[Recess.]

Senator **Pressler** [acting chairman]. The committee will again be in order.

We will continue with our last panel for today. We have Mr. Edward Muhl, insurance commissioner for the State of Maryland, representing the National Association of Insurance Commissioners; and Representative Woods Bowman of the Illinois House of Representatives, representing the National Conference of State Legislatures.

Your entire prepared statements will be included in the hearing record, and you may summarize your remarks as you wish.

We will begin with you, Mr. Muhl.

STATEMENT OF EDWARD J. MUHL, INSURANCE COMMISSIONER, STATE OF MARYLAND, BALTIMORE, MD

Mr. **Muhl**. Thank you, Mr. Chairman.

I might comment on some of the remarks, Mr. Chairman, by first suggesting to you that insurance regulators in the various States are not newcomers to the concerns and problems that you are addressing here today and about which I heard some of your witnesses testify today a little earlier. We have been on the frontline every day and every moment of every day in dealing with these concerns and problems and meeting with the day care folks, the long-haul truckers, obstetricians, municipalities, and counties, in addition to the insurance industry, all of whom are impacted by the situation that we find ourselves in today.

We feel that we have a good understanding of the problems and, equally important, a good understanding of the solutions needed.

You have my testimony. I won't go through that in a lot of detail, but let me attempt to summarize in some fashion and simply state or reiterate some of the concerns and problems.

First, you have several factors that have come about to influence the cycle and the situation that everybody finds themselves in today. You have, in my opinion and some of the statistics that I have seen—and I will also supply this to you, Mr. Chairman, and to your committee members, the information that I do have—you have a rising severity and a rising frequency in claims payouts by insurance companies.

You have an increase, in addition to the increase in severity and frequency, in the amount of the premium dollar that is now being paid for defense costs. The projection is that it is now at 33 cents for every dollar of premium received which goes out in the form of costs for defense of certain of these cases. That is a tremendous amount of money out of the dollar's worth of premium.

We have, in addition, the fear of the industry about getting into certain lines, but we have found that their greed has, in fact, overcome their fear to enter into certain of these lines, particularly some of the volatile lines.

There was money to be had. The insurance industry did participate in heavy competition in order to get a lot of the insurance in the cash-flow underwriting scheme, and they could do that with a certain degree of ease and a certain degree of reasonableness, because the interest rates were high. You had a world economy that had gone just a little bit crazy, and it was easy to get into a market, accept low premium income, and convert that low premium income to a high yield return on interest.

A lot of this business they had on the books was ill-priced business. But you were really caught in a situation, or at least the insurance industry was, in the past few years that even though they had this ill-priced business on the books, they could not and should not or attempted to, if you will, price the business as it should have been and collect the high interest rates, because they would have been gouging the public.

The individual insurance regulators forced the issue by advising them and forcing them in many instances to reduce the amount of the premium, because they had the high interest return. This would have been fine for a period of time until the economy changed and changed dramatically. You had a tremendous decrease, a fast dramatic decrease, in the interest rates leaving a lot of long-term ill-priced business on the books, particularly for the commercial lines.

A lot of the insurance, Mr. Chairman, that you are seeing today and a lot of the concerns and complaints, particularly, say, from the day care folks or the restaurant and tavern owners and bar owners, is specialty business. I just want to outline just for a moment—there are about 5,500 companies licensed in the United States. After you take out those which insure strictly for life and health, those that are in the personal lines of property casualty coverage, you only have about 1,100 companies that offer insurance in some form or fashion in the commercial lines that you are discussing today that affect the small businesses.

Out of these 1,100 or so companies which are licensed in the United States, not all of them are licensed in each of the jurisdictions, and not all of them have the same capacity to write insurance. Not all of them write the same kinds of insurance, and not all of them have the same expertise to write certain lines of insurance.

For example, and I had the pleasure of appearing before you one time previously, we were talking about the day care industry's concerns and problems early into this stage. We find that the bulk of the business that was written for day care was written by one major company. That was mainly for the commercial centers, and that was by Mission Insurance Co.

Mission Insurance Co., for example, in Maryland, insured 241 of our day care centers, as they insured quite a few throughout the United States. They specialized in that market. Mission Insurance Co., sustained some rather severe losses. They were in a position where they lost their reinsurance contracts and, ultimately and most recently, were taken over in rehabilitation by the California Insurance Commissioner.

It has dislocated, as a result, a lot of the day care centers that were insured through Mission. Other commercial carriers were not in a position, they were not geared up in some instances, or they were not able in other instances, and in yet other instances they were unwilling to venture into a new area of writing day care. Again, that was a specialty line. Not many companies were writing that sort of business. And I am again referring to the commercial lines.

You did have in the day care situation a lot of homeowner personal lines such as State Farm, Nationwide, Allstate, and some others who were writing as a rider to their homeowner's policy the liability coverage needed for the family day care of six and fewer kids.

You had a similar situation with Transit Casualty Insurance Co., that insured a lot of the transportation facilities. I know in my State, for example, they had mass transit system. They had a lot of the restaurant and bar owners and tavern owners. This company is now in liquidation as a result of going broke and is now out of the business of insurance. And that has also caused a dislocation of a lot of the insureds having now to seek coverage elsewhere. And a lot of the other companies, again, are not specializing in those markets and, having difficulties of their own, really are not in a position, for the most part, of either picking up new business or even continuing some of the existing business.

We have had, as I indicated, Mr. Chairman, an increase in severity and frequency of claims and the amounts of payouts by the insurance companies. I also indicated to you that the insurance industry itself has helped to self-inflict some of the wounds that they sustained in this whole process.

When you had a situation where the insurance companies, as a result of the interest rates falling, should have gotten out of that cash-flow underwriting process, and they could have at a point in time still sustained loss but it would have been less of a loss than they sustained by bringing their products back to a more reasonable pricing as to the product itself and the payout of that product. But competition, competitive forces, had taken hold.

There was one company, and the company, specifically, was Aetna which early on attempted to get out of this situation of keeping their prices low, while maintaining market shares. They were just getting out of that cash-flow underwriting process, because they were losing money. They attempted, and within the first 4 months, lost a great percent of their market share. A lot of it was good insureds that just left the process.

It was very difficult. They participated in the cash-flow underwriting business way too long. A lot of the insurance regulators found themselves in a very difficult position, myself included.

I thought I would never, ever be in a position of telling an insurance company that they were charging too little premium to the insureds. And it is very difficult to go to some manufacturer or some restaurant or day care folks and say that your premium is too low and you ought to be paying more, but several of the regulators did force that issue. I issued several orders to the various companies that we determined were charging inadequate rates at the time and ordered them to raise their rates.

We were just waiting for the moment when they would come to get me to put me away, but, fortunately, that didn't happen.

So, we were in a position where the economy, increase in losses, and the cash-flow underwriting process has really caused a lot of the severe problems that we have today.

The remainder of the written statement, Mr. Chairman, you indicated that you are going to put into the record. I will stop at this point and wait for any questions that you might have.

[The prepared statement of Mr. Muhl follows:]

NAIC

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*National
Association
of Insurance
Commissioners*

February 21, 1986

The Honorable Lowell Weiker, Jr.
Chairman
Senate Small Business Committee
United States Senate
Washington D. C. 20510

Dear Mr. Chairman:

My name is Edward J. Muhl, Insurance Commissioner of the State of Maryland and Vice President of the National Association of Insurance Commissioners. I am here representing the NAIC which is an association of all the regulatory officials of the fifty states, District of Columbia and the four U. S. territories of Guam, American Samoa, Virgin Islands, and Puerto Rico.

On behalf of my many colleagues and the NAIC, we thank you for the opportunity to appear before your committee and to offer testimony which we hope you will find of benefit and interest.

Attached to this written testimony you will find a copy of a recently conducted survey the NAIC conducted of the states in order to determine specific problem lines of insurance.

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Mr. Chairman, allow me to preface my remarks by first noting that the State Insurance Regulators are not newcomers to the problems that you are addressing. We have been on the front line dealing with these issues every moment of every day listening to the complaints of the family day care operators, the long-haul truckers, obstetricians, municipalities and counties and the many others, including the insurance industry, who are affected and impacted by this situation.

We have a good understanding of the problems, and equally important, a good understanding of the solutions needed. Many solutions have already been offered which have been molded to the best interest of the citizens in our individual jurisdictions. The solutions that could positively impact on the problems have already been implemented and a lot of what can be done, has been done, by the several states.

The insurance industry and the individual companies that comprise this industry are not unregulated. As a matter of fact, they are highly regulated, and, in my opinion, well regulated by the many states. There are critics, Mr. Chairman, of the state regulation as there are critics of federal regulation. But I strongly suggest to you and to your committee that state regulation of insurance is alive and well and quite capable of responding to the needs of the citizens we serve on matters within our control.

The National Association of Insurance Commissioners serves to bring together the state regulators, to share in the problems and particularly the solutions that transcend jurisdictional boundaries. Our organization assists in supplying the uniformity needed in those most critical areas dealing with solvency and financial regulation and, at the same time, provides for the individuality of the several states where some problems and the solutions to those problems are unique. The NAIC provides a national forum but assures individual state identities because not all states are experiencing the same problems nor the same degree of severity. Each state is unique and the problems they face, although having some similarities may be different as the solutions will be different.

In order to fully understand the availability concerns existing today, it is important to understand the several component parts of the problem that has brought us to this point.

There are approximately 5,500 licensed United States insurance companies of which approximately 2,100 are life and health insurance carriers. The remainder, 3,400, are property/casualty insurers. This 3,400 is further identified as having approximately 53% who underwrite personal lines of insurance only such as automobile and homeowners, and the remainder of the 1,600 are licensed to write commercial insurance which includes workers compensation, commercial automobile, commercial multi-peril and commercial general liability and specialty lines. If you exclude workers compensation companies, you would have approximately 1,100 companies writing various of the commercial lines in question.

Each of these companies represent individual independent businesses of different sizes and different capacities or abilities to write insurance, who are seeking to sell their products, pay expenses and earn a profit not unlike any other businesses that function in our free enterprise system. Each insurer who ventures into this business of risk taking and risk sharing does so with the logic and thought that if they can predict their loss exposure, they can charge an appropriate premium and thus make a profit. Unfortunately, it's not a very simple or easy process because of the many forces that come to bear on the system. Competition, government and regulatory controls and intervention, predictability and measurability of risk exposures, reinsurance, world economies and the management ability of individual insurers to name a few, serve to have a direct as well as indirect bearing on the functioning of this system as a whole.

The business of insurance historically has been cyclical in nature. The companies evaluate their risks, attempt to predict with as much certainty as possible their future losses, and adjust their premium, up or down, to cover those predictions as to losses while attempting to remain competitive. The pendulum, in years past, would swing in near three year cycles due, in part, to a degree of stability that existed in a world economy, the ability to spread the risks over a large base of insureds and an availability of secondary or reinsurance to fill the capacity voids of the primary insurers.

The task though of predicting future losses, measuring and evaluating risks and spreading that risk has become difficult. Narrowly defined and limited contracts have been broadened by judicial interpretation. Insurers on a consistent basis are being required to pay for risk exposures that were never intended or contemplated by the insurance contract and, equally important, where a premium was not previously collected for such an exposure.

The bulk of this has translated into solvency concerns for major segments of the insurance industry. and thus directly impacts on the ability or the capacity of the industry to write either new or existing lines of insurance. The primary carriers in the United States market never had the capacity to write all the insurance demanded by the various markets. Therefore, there was a strong reliance on the reinsurance facilities to fill this capacity void. Unfortunately, the losses sustained by the primary carriers have also been sustained by the reinsurance facilities which has caused them to reevaluate their position in the market. Reinsurance has been disappearing for certain of these lines or the costs of reinsurance to the primary carriers have increased dramatically for yet other lines, thus exacerbating the problems noted.

The insurance industry is responsible for self-inflicting some of the wounds they sustained due in part to their participation in the cashflow underwriting process. We had an uncontrolled economy with double digit inflation and an unprecedented prime interest rate of 21% leaving open the door for the many insurers to indulge in certain practices which aggravated and worsened the cycle. Insurers were able to convert low premium dollar income for high short-term investment yields, thus creating a large volume of ill priced and, in some instances, long-term business on their books. Competitive forces were quite fierce.

The interest rates fell dramatically over a relatively short period of time leaving the insurance industry in quite a dilemma. There was a fear that to raise prices in some semblance of order to compensate for the risk exposures would mean a loss of marketshare. The industry, for the most part, was unwilling to make such a timely transition and was severely caught in a time lag of recovery. To make matters worse, many companies, now experiencing solvency concerns and with fear for survival, were withdrawing from many of the markets totally. There has been an overreaction in many instances where some of the companies have withdrawn from the unprofitable as well as the profitable markets causing dislocation of many policyholders.

It is important to remember that all insurance companies do not write the same lines of insurance nor do they have the same capacity or expertise. Much of the commercial business is written by specialty companies or companies that specialize in certain markets. Medical malpractice for an example, is written in varing degrees and amounts by approximately 30 insurance companies. Day care, particularly commercial day care centers were written by just a few carriers, Mission Insurance Co. being the primary one. Mission ultimately sustained capital and surplus deficiencies and was unable to retain certain of its reinsurance contracts.

Mission was recently taken over in rehabilitation, thus dislocating quite a few day care centers nationally. Many of the other commercial lines carriers were not geared to write such coverages and due to the perceived volatile potential for loss, few if any initially moved to fill this capacity void.

Many factors, some controlled while others uncontrolled came to bear on the industry thus creating the most severe cycle in the history of insurance. State governments and regulators responded by offering immediate relief where possible and identifying other short term as well as longer term solutions to the many problems. The individual states as well as the NAIC responded promptly by creating market assistance programs, searching for alternative insurance sources, establishing a national clearinghouse of availability information and exploring legislative involuntary insurance mechanisms such as Joint Underwriting Associations. Using my state as an example, Governor Hughes of Maryland,aware of the then growing availability problem, supported legislation in the 1985 General Assembly that allowed Maryland's Medical Malpractice Insurance Company to expand it's writings to other health care professionals. This has served to create an available malpractice market for nurse mid-wives, dentists, and other health providers.

Concerned also with the severity of the availability and affordability problems, Governor Hughes formed two separate task forces, one on medical malpractice and one on general liability for the other commerical markets. The major thrust was to identify specific causes of these problems and to determine the most appropriate administrative and legislative solutions. The Governor has submitted a comprehensive package of bills to the legislature that will have a meaningfull impact on these problems. Many of the state jurisdictions are proceeding in a similar manner.

The individual state regulators in coordination with the NAIC responded to these problems. The following represents a summary of the various actions taken:

1. There has been a universal response by all state insurance departments by law, order, regulation or notice prohibiting companies from cancelling at mid-term of policy contract or attempting to raise premiums mid-term of contract.

2. Proper notice of non-renewals is being required to allow the insured sufficient time to find alternative markets.

3. The majority of states have created voluntary market assistance programs and open telephone hotlines. The market assistance programs are efforts to create markets where none presently exist, matching buyer and seller of insurance. These efforts have worked quite well, particularly in the area of day care liability.

   The NAIC has responded by creating a National Clearinghouse concept gathering information as to specific company capacity in specific geographic areas and disseminating that information to the states for use in their market assistance programs.

4. Market conduct examinations are being initiated by the states of any insurer whose market practices and activities are questioned. Several examinations have commenced and have been completed. Insurance companies found in violation of any of the insurance laws are taken to task.

5. Many states are addressing availability problems by sponsoring legislation which creates involuntary insurance mechanisms such as Joint Underwriting Associations (JUAs). As a prerequisite to licensure, all companies licensed in a given state will have to accept certain of these risks as insureds with that company.

6. The majority of the states, either through their Governor's Office, Insurance Division or the State Legislatures have formed special task forces to review the unique problems of these states and to suggest legislative remedies. These legislative initiatives take various forms depending upon the need of the local jurisdiction. Some of the noted initiatives deal with meaningful reform of the legal liability system: (a) caps on awards; (b) reinstitution of governmental immunity; (c) re-evaluation of competitive rating versus prior approval rating mechanisms; (d) joint underwriting associations or legislatively created market alternatives such as medical mutual liability insurance companies, lawyer's malpractice insurance mechanisms and other residual market mechanisms; (e) malpractice arbitration mechanisms for health providers; (f) strengthening peer review and professional licensing procedures (g) elimination of legal barriers allowing for pooling of risks and self-insured programs for governmental entities; (h) limiting counsel fees in certain circumstances based on percentage of the award; (i) reducing the statute of limitations in cases of a minor.

7. The NAIC has formed a legal liability task force to review the legal liability system and the effect it has on the consumer and the availability of insurance generally.

8. Premium rates are being monitored and reviewed to determine whether the rates charged are excessive for the product being sold and the risk exposure that is attached. Premium rates are also being monitored to determine if they are inadequate as well as unfairly discriminatory.

The states share in the concerns of availability and affordability and the impact this has on our citizens, insurance consumers, and industry alike. Many efforts are being made to resolve these problems, and we are pleased to suggest that a great deal of progress has been made. Insurers are rebounding and voluntary efforts are being seen to address these concerns. Continental Insurance Company, USF&G, and Liberty Mutual, to name three, have announced insurance programs created to insure day care facilities. Other carriers have initiated programs to insure yet other commercial entities which is a positive sign of recovery.

There are risks, though, that cannot and probably should not be insured because of the inability to measure the cost of such risks. I refer to pollution liability in its various forms as one example. Unless changes are made, and the liability system provides more stability, these risks will not be insurable at any cost.

We are finding many businesses and individuals going self insured for many risks which result only in a temporary or interim solution. The difficulty remains in that by self insuring, they are merely transferring the method of payment and not addressing the root cause of the rising cost.

The last issue that I would like to address deals with solvency. One of the most important roles of a regulator, in addition to consumer protection, is insurance company solvency protection and insolvency detection. When a company enters into an insurance contract and collects a premium, they make a promise and a commitment to the policyholder. These policyholders come to rely on that promise and it is important to assure that these companies remain viable and able to fulfill their promise and commitment one year, five, twenty or thirty years in the future. In the unfortunate event of an insolvency, the policyholders' interest must also be protected.

The individual state regulators take their statutory charge quite seriously and attempt to provide those protections necessary. For your information, Mr. Chairman, the many states provide, in coordination with one another and with the assistance of the National Association of Insurance Commissioners, one of the most advanced solvency monitoring mechanisms available. We are able to devote staff resources in excess of 6,000 personnel to the various regulatory functions. There are over 1,800 highly qualified and experienced financial and market conduct examiners, and the states contribute over 200 million dollars each year toward the cost of regulation.

On behalf of the NAIC and my many colleagues, I would like to again thank you for the opportunity to appear before your committee to offer testimony. I will be pleased to answer any questions you or your committee members may have.

Respectfully submitted,

Edward J. Muhl
Vice President NAIC

Senator **Pressler**. Thank you very much.
Mr. Bowman.

STATEMENT OF HON. WOODS BOWMAN, REPRESENTATIVE, ILLINOIS HOUSE OF REPRESENTATIVES, EVANSTON, IL

Mr. **Bowman**. Thank you, Senator Pressler.

I am Representative Woods Bowman from Evanston, IL. I am here before you today as a representative of the National Conference of State Legislatures. I serve as vice chairman of NCSL's Government Operations and Regulation Committee which has jurisdiction over several issues, including liability insurance availability and affordability.

I will not read my entire text, but I would like to read excerpts from it to highlight my points.

Senator **Pressler**. We shall place your entire text in the record.

Mr. **Bowman**. Thank you.

I simply wish to highlight certain points.

First of all, over 1,200 pieces of legislation posing a wide array of potential remedies have already been introduced in the State legislatures of our Nation, including, Mr. Chairman, 33 in your home State of South Dakota. It is premature to say with any degree of accuracy just what legislation will pass or what will provide short- and long-term relief regarding costs and availability of liability insurance, but I do want to assure this committee and the Senate of the United States that it is an item that has the highest priority in every one of the 50 States.

It is obvious that the State legislators are responding expeditiously to the crisis. Many States, including Maryland, Washington, Colorado, and Michigan have completed interim study reports. Several others, including New York, Arizona, Texas, and Illinois currently have task forces, commissions, or special study groups surveying the extent of the problem and weighing the potential impact of proposed solutions.

NCSL itself has made liability insurance one of its top priorities and has published several reports, some of which have been previously shared with this committee's membership. And I will indicate at this time that there are three other reports that are in the works and will be available very soon: "Liability Insurance: Federal Jurisdiction and Initiatives," "Regulatory Initiatives and Liability Insurance," and "Risk Management Practices" are the titles of these reports that are now in preparation. We expect them to be available within the next 2 months.

In my home State of Illinois, five of Chicago's suburbs and the city of Decatur have had difficult experiences in obtaining liability insurance. Three cities, Rockford, Naperville, and Arlington Heights have opted for self-insurance, as has Springfield's public transit system.

Elsewhere in the State, Pringle Express Trucking has ceased operations because it could not pay the quoted premiums from providers. A Bellville asbestos removal contractor has reported that he is experiencing a similar fate, and the village of Robbins has been ordered to pay a $750,000 judgment won by a former police officer, and that village had gone bare because of the current insurance prices.

I have brought with me some materials that I will make available to the committee to provide further illustrations, particularly in the area of day care. I have an article from my own neighborhood newspaper from October 1985 detailing some specific insurance problems in specific day care centers. I have some material from the Day Care Action Council of Illinois that includes a letter from a member of the State advisory committee on day care. Let me just read one short paragraph from that letter in terms of the solutions that are being considered:

> I am aware of recent legislation to allow claims made coverage and feel I know enough about the issue to know that we do not want that, even though it promises lower premiums in the short term. Illinois may be considering exclusionary language. I object to this also, even if an allegation against the center—however ridiculous and unfounded—could bankrupt the program in the cost of legal defense and not a part of the insurance.

Illinois has approached the problem in several ways.

I beg your pardon. I forgot to add that I have some material here from the United Way of Chicago which has done a detailed survey of 57 recipient agencies and has provided excellent statistical information regarding different lines of insurance rather than merely pooling all the data in an aggregate.

We have approached the problem several ways. Each of the actors in the process has taken to date directly or indirectly ought to relieve the liability insurance problems which small businesses have.

Last October, we passed Senate bill 907 which forbids mid-term cancellations of policies unless there are specific provisions, such as nonpayment of premiums. House bill 2607 has been introduced requiring that a 90-day notice of cancellation be sent to insureds. On December 2, our insurance department launched a market assistance plan which has helped small business and others with insurance availability difficulties. And on and on.

I would just say that I have provided here a list of about three pages of remedies that the States are pursuing. In response to a question that was raised by Senator Levin to the previous witnesses where he asked the witnesses to demonstrate or testify to a failure of State regulation, let me just say that by June 30, two-thirds of the States will have completed their legislative sessions for this year and will have considered many of the items on this three-page list.

I believe it would be appropriate and useful, in fact, for the Senate not to move ahead prior to that time, because, among other things, we will have generated many issue analyses and task force reports that I believe will be useful to the Senate's deliberation. And I believe a more definitive answer to Senator Levin's question about what the States are doing or are not doing will be available at that time.

Let me just conclude my testimony with some specific NCSL positions that we would like to bring to the attention of the committee.

First, we feel that States should work out the problems with affordability and availability of liability insurance. This is not a dismissal of the possible need for examining the McCarran-Ferguson Act, anti-trust exemptions, Federal reinsurance, and the idea of Federal regulatory standards which some groups have raised.

The potential role of the Federal Government in liability insurance is a subject which NCSL's State-Federal assembly will review further in May of this year. Over half the States will have concluded their sessions by then—I think it is about two-thirds—and we ought to have an excellent understanding of State capacity to manage the various aspects of existing liability insurance problems.

Second, Congress should take corrective action in areas such as environmental liability insurance, truckers' coverage, and the Price-Anderson Act where the Federal Government already has jurisdiction.

Third, we hope the Congress will cooperate with organizations such as NCSL and other State and local governments and their organizations to identify remedies which will potentially work to ensure that situations such as we have today do not occur again.

Fourth, we hope the Congress will intervene where it appears that States have exhausted all proposed remedies, where their impacts have been analyzed, and have found that problems with affordability and/or availability yet persist.

Fifth, we are optimistic that hearings will continue which will heighten the understanding of the existing crisis and provide a forum for remaining current on State developments. This issue is a moving target with nationwide and even international overtones. NCSL remains ready to assist the Congress in its deliberations.

Lastly, I would enter into the record an editorial from the Wilmette Life which is a north shore suburban Chicago newspaper. The north shore of Chicago is home to many small businessmen and also many insurance executives. The title of the editorial is "Insuring Sound Change." After review of the issues, it concludes that much more information is needed before sound revision, particularly in the tort reform area, can proceed, and it recommends that perhaps 1987 would be the year for that and instead recommends for the current year to do some fine tuning but really urges a go slow approach which I believe is consistent with the NCSL policy of giving the States a chance to work out these problems themselves.

Thank you.

[The prepared statement of Mr. Bowman follows:]

STATEMENT OF REPRESENTATIVE WOODS BOWMAN, ILLINOIS HOUSE OF REPRESENTATIVES

I AM STATE REPRESENTATIVE WOODS BOWMAN OF EVANSTON, ILLINOIS. I APPEAR BEFORE YOU TODAY AS A REPRESENTATIVE OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES. I SERVE AS A VICE-CHAIR OF NCSL'S GOVERNMENT OPERATIONS AND REGULATION COMMITTEE WHICH HAS JURISDICTION OVER SEVERAL ISSUES INCLUDING LIABILITY INSURANCE AVAILABILITY AND AFFORDABILITY.

THE NATIONAL CONFERENCE OF STATE LEGISLATURES (NCSL) IS THE OFFICIAL REPRESENTATIVE OF THE NATION'S 7,461 STATE LAWMAKERS. THE ORGANIZATION PROVIDES BASIC ISSUE RESEARCH, TECHNICAL ASSISTANCE, COMPREHENSIVE FEDERAL BUDGET AND FUNDING DATA AND TRAINING SERVICES FOR LEGISLATORS AND THEIR STAFFS. SINCE ITS CREATION IN 1975, NCSL HAS ALSO SERVED AS THE WASHINGTON, D.C. LIAISON FOR ALL STATE LEGISLATURES. NCSL'S STATE-FEDERAL ASSEMBLY HAS ADOPTED POLICIES ON A RANGE OF ISSUES AFFECTING INTERGOVERNMENTAL RELATIONS, INCLUDING LIABILITY INSURANCE.

I APPRECIATE THIS OPPORTUNITY TO SHARE WITH YOU NCSL'S CONCERNS REGARDING THE AFFORDABILITY AND AVAILABILITY OF LIABILITY INSURANCE. THIS ISSUE RANKS AT THE TOP OF VIRTUALLY EVERY STATE LEGISLATURE'S AGENDA IN 1986. AMONG THE SEVEN STATES NOT IN SESSION, INTERIM STUDY GROUPS ARE OCCUPIED PRIMARILY WITH THE CAPACITY CRISIS. NORTH CAROLINA CONVENED A SPECIAL SESSION ON THIS ISSUE THIS WEEK AND MONTANA HAS SIMILAR PLANS FOR MARCH.

OVER 1,200 PIECES OF LEGISLATION POSING A WIDE ARRAY OF POTENTIAL REMEDIES HAVE ALREADY BEEN INTRODUCED. LEGISLATION HAS BEEN ACCOMPANIED BY UNCOUNTED REGULATORY INITIATIVES. IT IS PREMATURE TO SAY, WITH ANY DEGREE OF ACCURACY, JUST WHAT LEGISLATION WILL PASS OR WHAT WILL PROVIDE SHORT-AND LONG-TERM RELIEF REGARDING COST AND AVAILABILITY OF LIABILITY INSURANCE.

WHAT IS OBVIOUS IS THAT STATE LEGISLATORS ARE RESPONDING EXPEDITIOUSLY TO THE CRISIS. MANY STATES, INCLUDING MARYLAND, WASHINGTON, COLORADO AND MICHIGAN HAVE COMPLETED INTERIM STUDY REPORTS. SEVERAL OTHERS, INCLUDING NEW YORK, ARIZONA, TEXAS AND ILLINOIS, CURRENTLY HAVE TASK FORCES, COMMISSIONS OR SPECIAL STUDY GROUPS SURVEYING THE EXTENT OF THE PROBLEM AND WEIGHING THE POTENTIAL IMPACT OF PROPOSED SOLUTIONS. NCSL HAS MADE LIABILITY INSURANCE ONE OF ITS TOP PRIORITIES AND HAS PUBLISHED SEVERAL REPORTS (SOME OF WHICH HAVE BEEN PREVIOUSLY SHARED WITH THIS COMMITTEE'S MEMBERSHIP) AND HELD SEVERAL NATIONWIDE SEMINARS AND PUBLIC MEETINGS ON THE SUBJECT.

SCOPE OF THE PROBLEM

BOTH PUBLIC SECTOR AND PRIVATE SECTOR ORGANIZATIONS FACE SEVERE PROBLEMS FINDING AFFORDABLE LIABILITY INSURANCE. MANY ORGANIZATIONS HAVE BEEN FACED WITH MID-TERM CANCELLATIONS AND NON-RENEWALS. CERTAIN LINES OF INSURANCE HAVE RISEN SO HIGH AS TO MAKE THE INSURANCE IN EFFECT UNAVAILABLE. ALTHOUGH INSURANCE IS A CYCLICAL INDUSTRY, THIS CRISIS IS MORE SEVERE THAN CRISES WE HAVE FACED IN THE PAST. IT IS THE SIMULTANEOUS COMING TOGETHER OF MANY PROBLEMS WHICH MAKES THIS CRISIS MORE SEVERE.

THE PRIVATE SECTOR, SMALL BUSINESS SPECIFICALLY, HAS BEEN HARD HIT BY THE CRISIS. SOME ENTREPRENEURS AND SERVICE PROVIDERS UNABLE TO GET INSURANCE, HAVE LOST THEIR LICENSES TO DO BUSINESS. ALMOST EVERY BUSINESS AND NONPROFIT ORGANIZATION IS TOUCHED IN SOME WAY AND MANY ARE SEVERELY IMPACTED.

THE PUBLIC SECTOR HAS BEEN DIRECTLY AFFECTED. STATE AND LOCAL GOVERNMENTS ARE BROADLY EXPOSED TO LIABILITY AND INSURANCE PROBLEMS GIVEN THE RANGE OF GOVERNMENTAL ACTIVITIES. AS A RECENT PENNSYLVANIA HOUSE OF REPRESENTATIVES REPORT STATED: "...INSURANCE MARKET ECONOMICS AND DYNAMICS APPEAR TO BE

ILL-SUITED TO DEAL WITH THE SPECIAL SOCIAL AND POLITICAL STATUS OF MUNICIPAL ENTITIES." ALTHOUGH A STATE OR LOCALITY MAY BE FINANCIALLY HEALTHY, IT STILL MAY NOT HAVE THE RESOURCES TO BE ENGAGED IN LENGTHY AND COSTLY COURT BATTLES. THUS, STATES AND LOCALITIES ARE A TARGET - A DEEP POCKET - WHICH CAN BE PRESSURED TO SETTLE. STATE AND LOCAL GOVERNMENTS HAVE ALSO BECOME A MORE ATTRACTIVE TARGET WITH THE LOSS OF SOVEREIGN IMMUNITY. ONLY 7 STATES RETAIN THE FULL PROTECTION OF SOVEREIGN IMMUNITY TODAY (ALABAMA, ARKANSAS, DELAWARE, KENTUCKY, NORTH DAKOTA, VIRGINIA, AND WEST VIRGINIA). TOTAL IMMUNITY FOR MUNICIPALITIES EXISTS IN ONLY 4 STATES (ARKANSAS, DELAWARE, OHIO AND VIRGINIA).

INCREASED LITIGIOUSNESS AND GREATER TOTAL DOLLAR CLAIMS PAYMENTS HAVE SOMEWHAT COMPROMISED PREDICTABILITY WITHIN AN INDUSTRY WHERE PREDICTABILITY HAS USUALLY BEEN DIFFICULT TO GAUGE. MIX THIS WITH THE NEED TO PROVIDE REASONABLE COMPENSATION TO INJURED PARTIES, ENSURE DUE PROCESS AND EQUAL PROTECTION OF THE LAW AND YOU HAVE A MAJOR CHALLENGE.

STATE REGULATORY PRACTICES AND RESOURCES HAVE COME INTO QUESTION. CONTROL OVER RATE-SETTING AND EFFECTIVE OVERSIGHT OF INSURERS APPEARS TO RUN THE ENTIRE QUALITY GAMUT. TO WHAT EXTENT REGULATORS ALONE COULD HAVE PREVENTED OR TEMPERED THIS CRISIS IS A MATTER WHICH VIRTUALLY EVERY STATE IS ADDRESSING.

THESE ARE MERELY EXAMPLES OF A MYRIAD OF PROBLEMS WITH WHICH THE FIFTY STATES, TO VARYING DEGREES, ARE CONFRONTED.

SPECIFIC PROBLEMS FOR ILLINOIS

PROBLEMS FOR SMALL BUSINESS IN ILLINOIS MIRROR MANY OF THOSE BEING EXPERIENCED NATIONWIDE. DAY CARE PROVIDERS, TRUCKING COMPANIES, RETAIL LIQUOR STORE OPERATORS, HAZARDOUS WASTE OPERATORS, AMUSEMENT AND RECREATIONAL FACILITY OWNERS ARE AMONG THE SEVERAL BUSINESSES HIT DRAMATICALLY WITH EXORBITANT PREMIUM

INCREASES. IN RECENT TESTIMONY BEFORE ILLINOIS' GENERAL ASSEMBLY, SMALL BUSINESSMEN REPORTED PREMIUM INCREASES RANGING FROM 25% - 1,000%.

MIDTERM CANCELLATIONS BECAME SO COMMONPLACE THAT ILLINOIS' INSURANCE COMMISSIONER SET UP A MARKET ASSISTANCE PLAN TO ADDRESS PROBLEMS WITH UNAVAILABILITY. OF COURSE, UNAVAILABILITY DOES NOT DISAPPEAR WHEN THE PREMIUM TO BE PAID IS OR BORDERS ON BEING UNAFFORDABLE. I AM PARTICULARLY WARY THAT SMALL BUSINESSMEN MAKING THE INITIAL PREMIUM PAYMENT, AT A MUCH HIGHER COST, MAY FAIL TO HAVE THE NEEDED RESOURCES TO MAKE FUTURE PAYMENTS ON THEIR POLICIES.

SMALL TO MODERATE SIZE GOVERNMENTS HAVE BEEN DEALT SIMILAR UNAVAILABILITY LAWS. KNOX, LIVINGSTON AND MADISON COUNTIES HAVE HAD DESPERATE PROBLEMS SECURING AMPLE INSURANCE. 5 CHICAGO SUBURBS AND THE CITY OF DECATUR HAVE HAD SIMILAR EXPERIENCES. THREE CITIES, ROCKFORD, NAPERVILLE AND ARLINGTON HEIGHTS HAVE OPTED FOR SELF-INSURANCE, AS HAS OUR CAPITAL CITY'S PUBLIC TRANSIT SYSTEM, RATHER THAN CONTINUE TO TACKLE THE CYCLICAL PREMIUM ROLLER COASTER, WHICH MOST BUSINESSES AND GOVERNMENT CHOOSE.

PRINGLE EXPRESS TRUCKING HAS CEASED OPERATIONS BECAUSE IT COULD NOT PAY THE QUOTED PREMIUMS FROM PROVIDERS. A BELLEVILLE ASBESTOS REMOVAL CONTRACTOR HAS REPORTED THAT HE IS LIKELY TO FACE A SIMILAR FATE. THE VILLAGE OF ROBBINS WAS ORDERED TO PAY A $750,000 JUDGEMENT WON BY FORMER POLICE OFFICER. THAT VILLAGE HAD "GONE BARE" BECAUSE OF THE CURRENT CRISIS. A NAPERVILLE PLUMBING FIRM AND A DOWNSTATE ILLINOIS ROOFER ARE TWO OTHER EXAMPLES OF SMALL BUSINESSES WHOSE FUTURE CAPACITY TO OPERATE HAS BEEN COMPROMISED BY INCREASED PREMIUMS.

ROOT CAUSES OF THE PROBLEM

JUDGING FROM MY OWN EXPERIENCE IN ILLINOIS AND FROM INFORMATION OBTAINED BY NCSL, THE CAUSES OF THE CRISIS ARE MANY. CASH FLOW UNDERWRITING AND INADEQUATE

PREMIUM INCOME, REGULATORY SHORTCOMINGS, RISING DOLLAR LOSSES FROM INCREASED JUDICIAL SETTLEMENTS, DISAPPEARING REINSURANCE, SUBSTANDARD RISK MANAGEMENT ANALYSIS AND SKYROCKETING PREMIUM INCREASES ARE AMONG THE FACTORS CONTRIBUTING TO THE CURRENT DIFFICULTIES. NEITHER NCSL NOR I HAVE YET TO COME ACROSS THE ANALYSIS WHICH CAN EASILY AND CONVINCINGLY DECIPHER WHICH FACTOR HAS CAUSED WHAT PROPORTIONATE AMOUNT OF THE PROBLEM. WHETHER THAT REPORT HAS BEEN OR WILL BE WRITTEN, I AM BOTHERED THAT GOVERNMENT AND SMALL BUSINESS ARE THREATENED WITH LOSS OF INSURANCE. THEY ARE, IN SOME INSTANCES, UTILIZING MORE OF ALREADY LIMITED RESOURCES TO REMAIN INSURED WHILE CUTTING OPERATIONS.

OTHER SUSPECTED CAUSES INCLUDE:

- INCREASED PREMIUMS REGARDLESS OF CLAIMS HISTORY.
- LOSS OR RESTRICTION OF SOVEREIGN IMMUNITY.
- DEFICIENT SAFETY PRACTICES RESULTING IN UNNECESSARY INJURY.
- UNPREDICTABLE INDUSTRY BEHAVIOR.
- UNCERTAINTY REGARDING NUMBER AND SIZE OF FUTURE CLAIMS AND LOSSES RESPECTIVELY.
- DECLINE IN RETURN ON INSURANCE INDUSTRY INVESTMENTS.
- UNDERCAPITALIZATION OF NEW ENTRANTS.
- COSTLY TRANSACTION COSTS IN TORT LITIGATION.
- FEAR OF UNMEASURABLE LIABILITY.
- JOINT AND SEVERAL LIABILITY.
- EXCESSIVE ATTORNEYS FEES.

STATE LEGISLATORS HAVE DIVERSE OPINIONS ABOUT WHICH OF THESE CAUSES ARE THE PRIMARY PRECIPITATORS OF CURRENT PROBLEMS. LINKAGES BETWEEN THESE CAUSES AND SOLUTIONS BEING POSED ARE DIFFICULT TO VERIFY. NEVERTHELESS, STATE LEGISLATURES ARE HARD AT WORK FASHIONING SOLUTIONS.

STATE ACTION

STATES HAVE TAKEN ON THE CHALLENGE OF THE CURRENT AFFORDABILITY AND AVAILABILITY CRISIS, BOTH IN PAST LEGISLATIVE SESSIONS AND IN CURRENT DELIBERATIONS, AS THE FOLLOWING EXAMPLES AND INFORMATION INDICATE:

- AS I MENTIONED EARLIER, OVER 1,200 BILLS HAVE BEEN INTRODUCED THIS YEAR ON THIS SUBJECT. THAT REPRESENTS ONE BILL FOR EVERY FIFTH LEGISLATOR IN SESSION. THAT COUNT RISES DAILY. AN NCSL REPORT ON THESE BILLS IS FORTHCOMING. NCSL WILL ALSO MONITOR EACH STATE'S BILL PROGRESS. I WILL SEE THAT THIS COMMITTEE RECEIVES ALL REPORTS EXPLAINING LEGISLATIVE AND ADMINISTRATIVE DEVELOPMENTS ON THIS TOPIC IN THE STATES.

- NEW JERSEY IMPLEMENTED, BY REGULATION, PROHIBITIONS ON MIDTERM CANCELLATIONS.

- AT LEAST NINE STATES (ARKANSAS, FLORIDA, ILLINOIS, LOUISIANA, MICHIGAN, MINNESOTA, OHIO, TENNESSEE AND TEXAS) PERMIT ESTABLISHMENT OF INSURANCE POOLS FOR GOVERNMENTS.

- NO LESS THAN 14 STATES (ARIZONA, CONNECTICUT, GEORGIA, ILLINOIS, KANSAS, MAINE, NEW MEXICO, MARYLAND, MISSISSIPPI, NEW HAMPSHIRE, SOUTH CAROLINA, VERMONT, VIRGINIA AND APPARENTLY TEXAS) HAVE IMPLEMENTED MARKET ASSISTANCE PLANS TO ENHANCE AVAILABILITY OF HARD-TO-GET LINES OF COVERAGE. THIS INFORMATION GETS DATED QUICKLY AND PROBABLY UNDERSTATES CURRENT STATUS.

- WEST VIRGINIA AND WYOMING ARE SERIOUSLY CONSIDERING ESTABLISHING COMPREHENSIVE SELF-INSURANCE FUNDS.

- CALIFORNIA'S SPEAKER OF THE HOUSE HAS CALLED FOR ESTABLISHMENT OF A STATE BOARD TO REVIEW INSURANCE RATES AND A STATE FUND TO INSURE COUNTIES AND CITIES.

- NEW YORK STATE IS CONTEMPLATING A 60-DAY MANDATORY NOTICE FOR NONRENEWALS AND PREMIUM CHANGES. SIMILAR LEGISLATION PASSED IN WASHINGTON STATE IN 1985.

- MICHIGAN'S SENATE HAS PASSED LEGISLATION CAPPING AWARDS FOR MEDICAL MALPRACTICE WHILE CONNECTICUT IS LOOKING AT LIMITING LAWYERS' FEES AND CAPPING PAIN AND SUFFERING AWARDS.

- PURSUANT TO AN EXTENSIVE STUDY OF THE STATE'S MUNICIPAL LIABILITY, NEW YORK MAY CONSIDER LIMITING JOINT AND SEVERAL LIABILITY AND ASSIGNING LAWSUITS AGAINST CITIES TO NONJURY TRIALS.

- AT LEAST 4 STATES (MISSOURI, OREGON, PENNSYLVANIA AND SOUTH CAROLINA) APPEAR TO HAVE INSTALLED CENTRALIZED RISK MANAGEMENT SYSTEMS.

- CALIFORNIA'S STATUTE RESTRICTING ATTORNEYS' FEES HAS BEEN UPHELD BY THE SUPREME COURT ALTHOUGH ILLINOIS' DAMAGE CAPS WERE STRUCK DOWN BY MY STATE'S TRIBUNALS.

ILLINOIS HAS APPROACHED THE PROBLEMS IN SEVERAL WAYS. EACH OF THESE ACTORS TAKEN TO DATE DIRECTLY OR INDIRECTLY OUGHT TO RELIEVE THE LIABILITY INSURANCE PROBLEMS WHICH SMALL BUSINESSES HAVE. LAST OCTOBER, WE PASSED SB 907 WHICH FORBIDS MIDTERM CANCELLATIONS OF POLICIES UNLESS SPECIFIC PROVISIONS, AS NONPAYMENT OF PREMIUMS, EXIST. LEGISLATION (HB 2607) HAS BEEN INTRODUCED REQUIRING THAT A 90-DAY NOTICE OF CANCELLATIONS BE SENT TO INSUREDS.

ON DECEMBER 2, OUR INSURANCE DEPARTMENT LAUNCHED A MARKET ASSISTANCE PLAN WHICH HAS HELPED SMALL BUSINESS AND OTHERS WITH INSURANCE AVAILABILITY DIFFICULTIES.

JUST RECENTLY, ILLINOIS' INSURANCE COMMISSIONER APPROVED AN AMENDED VERSION OF A "CLAIMS MADE" POLICY.

IN NOVEMBER, THE VILLAGE OF HOFFMAN ESTATES PASSED A REFERENDUM ESTABLISHING A CONSUMERS INSURANCE BOARD TO PROVIDE INSURANCE PRICE COMPARISONS FOR INSUREDS. LEGISLATION (HB 1988) ATTEMPTING TO ACCOMPLISH THE SAME STATEWIDE HAS BEEN INTRODUCED BUT HAS NOT MOVED.

BOTH THE HOUSE AND SENATE HAVE ESTABLISHED SELECT COMMITTEES WHICH ARE EXAMINING THE CAUSES AND POTENTIAL SOLUTIONS TO THE LIABILITY INSURANCE CRISIS.

BECAUSE THE PROBLEMS CONFRONTING STATE LAWMAKERS ARE MULTIPLE, IT IS EXTREMELY DIFFICULT TO ASSERT THAT ANY ONE ACTION OR GROUP OF ACTIONS WILL REMEDY THE ENTIRE CRISIS. AS WITH THE MID-70'S CRISIS WITH MEDICAL MALPRACTICE, THE LIKELIHOOD OF SOLVING AVAILABILITY PROBLEMS ARE RELATIVELY GOOD. PRICE, HOWEVER, REMAINS A MORE SERIOUS CHALLENGE. STATES NEED TIME TO ASSESS WHAT WILL AND WILL NOT WORK TO ELIMINATE OR CURB THE CRISIS. MARKETPLACE RECOVERY IS LIKELY TO BE OF ASSISTANCE, BUT IT MAY COME TOO LATE FOR THOSE "GOING BARE" OR REQUIRING INSURANCE TO CONDUCT BUSINESS OR PROVIDE SERVICES.

STATE REMEDIES

THE SOLUTIONS BEING DISCUSSED AND IMPLEMENTED BY STATES ARE EXCEPTIONALLY VARIED. SOME, AS MARKET ASSISTANCE PLANS, APPEAR TO BE SHORT-TERM REMEDIES. OTHERS, SUCH AS SELF-INSURANCE PLANS OR RISK POOLING, MAY PROTECT GOVERNMENT AND THE PRIVATE SECTOR FROM INSURANCE CYCLES. TORT REFORM INITIATIVES MIGHT TEMPER

LOSSES AND BRING SOME SENSE OF PREDICTABILITY TO UNDERWRITING. I USE TERMS AS "MAY", "APPEAR" AND "MIGHT" BECAUSE NOTHING LOOMS AS AN ABSOLUTE CERTAINTY AT THIS STAGE OF THE CRISIS.

A LENGTHY ROSTER OF ALTERNATIVE SOLUTIONS EITHER BEING DISCUSSED OR ALREADY IN PLACE AMONG THE STATES FOLLOWS. I SUBMIT THIS LIST NOT TO PRODUCE A LONGER PIECE OF TESTIMONY BUT RATHER TO APPRISE YOU OF THE DIVERSITY OF APPROACHES BEING PURSUED. NCSL IS REVIEWING THE INCIDENCE WITH WHICH EACH OF THESE IS APPEARING AND ATTEMPTING TO DOCUMENT WHAT IMPACT, BOTH SHORT-AND LONG-TERM, THESE POTENTIAL REMEDIES MAY HAVE ON AVAILABILITY AND AFFORDABILITY OF LIABILITY INSURANCE. THIS IS A TEDIOUS ENDEAVOR WITH UNCERTAIN OUTCOMES AT THIS POINT.

FOR SIMPLICITY'S SAKE, I HAVE CLASSIFIED REMEDIES BOTH IMPLEMENTED AND UNDER CONSIDERATION AMONG THE STATES INTO FOUR CATEGORIES:

1) REGULATORY INITIATIVES:

- PROHIBITIONS AND RESTRICTIONS ON MIDTERM CANCELLATIONS AND NONRENEWALS.
- REQUIRING PRIOR APPROVAL OF RATES RATHER THAN FILE AND USE ARRANGEMENTS.
- JOINT UNDERWRITING ASSOCIATIONS.
- MARKET ASSISTANCE PLANS.
- MODIFICATION OF OPEN COMPETITION RATING ACTS.
- UPGRADING STATE INSURANCE DEPARTMENT MANPOWER AND RESOURCES.
- REQUIRING RATES TO REFLECT LOSS EXPERIENCE.
- UTILIZATION OF "CLAIMS MADE" RATHER THAN "OCCURRENCE BASED" POLICIES.
- IMPROVED REGULATION OF NEW ENTRANTS.
- REGULATION OF SURPLUS LINE PROVIDERS.
- REQUIRING SUBMISSION OF DATA REGARDING INCIDENCE AND SEVERITY OF

CLAIMS LOSSES.

- LOWERING "SURPLUS" RATIOS FOR SPECIFIC LINES OF COVERAGE.
- LIMITING THE PERCENTAGE AMOUNT WHICH AN INSURER CAN VARY RATES FROM THE FIXED RATE.

2) RISK MANAGEMENT:

- ESTABLISH RISK RETENTION POOLS FOR CERTAIN LINES OF COVERAGE.
- STRENGTHEN DISCIPLINARY PROCEDURES IN ALL STATE AGENCIES REGULATING PROFESSIONS.
- ENHANCE HAZARD MANAGEMENT AND PUBLIC SAFETY.
- STRENGTHEN RISK ASSESSMENT TECHNIQUES.

3) MARKETPLACE INTERVENTION:

- LIMIT POLICY EXCLUSIONS.
- AUTHORIZE BANKS AND THRIFTS TO ENGAGE IN INSURANCE ACTIVITIES.
- REVIEW THE NEED FOR MANDATORY COVERAGE AND MANDATED LEVELS OF COVERAGE.
- RESTRICT ANNUAL PREMIUM INCREASES/DECREASES BASED ON EVIDENCE OF CHANGE IN RISK.
- REQUIRE NOTICE TO INSUREDS REGARDING CANCELLATIONS AND/OR NONRENEWALS.
- PROVIDE EXCESS PROFITS STANDARDS.
- ESTABLISH OR EXPAND RISK POOLING AUTHORITY.
- ESTABLISH OR EXPAND STATE REINSURANCE, BACK-UP INSURANCE AND SELF-INSURANCE PROGRAMS.
- PROHIBIT SURPLUS LINE PROVIDERS UNLESS APPROPRIATELY LICENSED.

4) TORT REFORMS:

- ESTABLISH COURTS OF CLAIMS TO HEAR SUITS AGAINST GOVERNMENT DEFENDANTS.
- ESTABLISH PRETRIAL SCREENING PANELS TO DETERMINE VALIDITY OF SUITS.
- IMPOSE PENALTIES FOR FILING FRIVOLOUS SUITS.
- ABOLISH/LIMIT PRE-JUDGEMENT INTEREST AWARDS.
- CAP NON-ECONOMIC AND PUNITIVE DAMAGES.
- CAP ATTORNEYS' FEES.
- ABOLISH OR MODIFY THE COLLATERAL SOURCE RULE AND JOINT AND SEVERAL LIABILITY.
- AUTHORIZE STRUCTURED SETTLEMENTS AND ITEMIZED JURY VERDICTS.
- REDEFINE STANDARDS OF CARE.
- REVITALIZE A RESTRICTED FORM OF SOVEREIGN IMMUNITY.
- MODIFY STATUTES OF LIMITATION.
- AUTHORIZE JUDGES ONLY TO DETERMINE DAMAGE AND AWARD AMOUNTS.
- ADOPT COMPARATIVE NEGLIGENCE STANDARDS.
- LIMIT THE DISCOVERY PROCESS.

FEDERAL ROLE

WHAT SHOULD THE U.S. CONGRESS DO TO RELIEVE THE COST AND UNAVAILABILITY OF LIABILITY INSURANCE FOR SMALL BUSINESS AND OTHERS? NCSL BELIEVES THE FOLLOWING STEPS WOULD BE MOST PRODUCTIVE FOR NOW:

1) PERMIT STATES TO WORK OUT THE PROBLEMS WITH AFFORDABILITY AND AVAILABILITY OF LIABILITY INSURANCE. THIS IS NOT A DISMISSAL OF THE POSSIBLE NEED FOR EXAMINING THE MCCARRAN-FERGUSON ACT, ANTI-TRUST EXEMPTIONS, FEDERAL REINSURANCE AND THE IDEA OF FEDERAL REGULATORY STANDARDS WHICH SOME GROUPS HAVE

RAISED. THE POTENTIAL ROLE OF THE FEDERAL GOVERNMENT IN LIABILITY INSURANCE IS A SUBJECT WHICH NCSL'S STATE-FEDERAL ASSEMBLY WILL REVIEW FURTHER IN MAY, 1986. OVER HALF THE STATES WILL HAVE CONCLUDED THEIR SESSIONS BY THEN AND OUGHT TO HAVE AN EXCELLENT UNDERSTANDING OF STATE CAPACITY TO MANAGE THE VARIOUS ASPECTS OF EXISTING LIABILITY INSURANCE PROBLEMS. ADDITIONAL STATE TASK FORCE REPORTS AND ISSUE ANALYSES SHOULD ALSO SERVE TO AID STATE LAWMAKERS IN ASSESSING THE NEED FOR ANY CONGRESSIONAL ACTION.

2) TAKE CORRECTIVE ACTION AT THE FEDERAL LEVEL IN AREAS, AS ENVIRONMENTAL LIABILITY INSURANCE, TRUCKERS' COVERAGE AND THE PRICE-ANDERSON ACT, WHERE THE FEDERAL GOVERNMENT ALREADY HAS JURISDICTION.

3) COOPERATE WITH ORGANIZATIONS AS NCSL AND OTHER LOCAL AND STATE GOVERNMENTS AND THEIR ORGANIZATIONS TO IDENTIFY REMEDIES WHICH WILL POTENTIALLY WORK TO ENSURE THAT SITUATIONS AS WE HAVE TODAY DO NOT RECUR.

4) INTERVENE WHEN IT APPEARS THAT STATES HAVE EXHAUSTED ALL PROPOSED REMEDIES, ANALYZED THEIR IMPACT, AND HAVE FOUND THAT PROBLEMS WITH AFFORDABILITY AND/OR AVAILABILITY PERSIST.

5) CONTINUE HEARINGS SUCH AS THESE WHICH CAN HEIGHTEN THE UNDERSTANDING OF THE EXISTING CRISIS AND PROVIDE A FORUM FOR REMAINING CURRENT ON STATE DEVELOPMENTS. THIS ISSUE IS A MOVING TARGET WITH NATIONWIDE AND EVEN INTERNATIONAL OVERTONES. NCSL WILL BE MORE THAN GLAD TO ASSIST WITH THE COMMITTEE'S FUTURE HEARINGS AND ANALYSIS THROUGH ADDITIONAL TESTIMONY AND INFORMATION.

MR. CHAIRMAN, I WANT TO THANK YOU FOR EXTENDING THIS OPPORTUNITY TO THE NATIONAL CONFERENCE OF STATE LEGISLATURES TO PARTICIPATE IN THESE HEARINGS AND I WILL GLADLY RESPOND TO ANY QUESTIONS WHICH YOU AND OTHER MEMBERS OF THE COMMITTEE MIGHT HAVE.

DAY-CARE
ACTION
COUNCIL OF ILLINOIS

4753 N. Broadway Street
Suite 726
Chicago, Illinois 60640
(312) 561-7900

February 14, 1986

Representative Woods Bowman
2100 Ridge Avenue
Evanston, Illinois 60201

Dear Woody:

I've pulled together several items from my insurance file which I hope will be of some help to you. As I said, the survey isn't as useful as it might have been. Centers whose premiums have been increased should not have been canceled. Also, we should have asked the average percentage increase in premiums, but did not.

When a center calls to say its insurance has been canceled, we have been making them aware of the coverage available through First Trust. First Trust still offers liability coverage which does not exclude claims arising from allegations of sexual abuse or corporal punishment. (The First Trust option is only open to incorporated not-for-profits; it's of no use to proprietary centers or licensed family day care home providers.)

Jim Stevens at the Department of Insurance-Market Assistance Program has given us the names of several agents in the state who will help home providers find coverage. I don't know exactly what's available from each agent, but I have heard of one policy providing $ 300,000 worth of coverage (excluding abuse) for a $600-650 annual premium.

I've also asked Maria to send you a recent fact sheet she received.

Sincerely,

Lee Kreader
Executive Director

Skip-A-Long Daycare Center
814 30th Avenue
East Moline, Illinois 61244
(309) 755-5035

Rainbow-Skip-A-Long II
Child Development Center
1609 Fourth Street
Rock Island, Illinois 61201
(309) 788-0426

Executive Director, Laurel Walker

January 8, 1986

Senator Schuneman
306 Washington Street
Prophetstown, Il 61277

Dear Senator Schuneman:

I watched with great interest the program "At Issue" on Sunday, January 5, as you and 4 others addressed the growing problem of liability insurance with host Dick Gage.

I was the caller towards the end of the program asking about day care- let me introduce mysel.. I am the administrator for 2 not-for-profit day care centers in Rock Island County. I have been involved in the insurance crisis since Fall of 1984 and during the months that followed have researched the subject, collected articles and tried to learn as much as I can about the problem. I am chairman for the Statewide Advisory Committee on Day Care to DCFS and also a Board member for the Day Care Action Council (based out of Chicago)- both of which have taken an active interest in this liability insurance problem.

You mentioned you are on the Senate Insurance committee. It is my understanding that Rep. Joel Brunsvold is on the House insurance committee. I would like very much to be kept abreast of possible legislation and new developments on this matter. Joel is quite familiar with our situation, for our 2 Centers experienced a 200% increase the first year and a 50% increase the second year and quite some trouble even locating a company willing to insure us. In our 15 years of incorporation, we have never filed a liability claim. This "clean record" is not unlike most of the troubled day care programs who are having great difficulty securing insurance coverage, let alone working the premium increases into the budget.

I heard Patrick Quinn's argument for the Citizens Advisory Board, the opinion that the courts must make some drastic national changes and that setting limits on damages might be yet another solution. I am aware of Iowa's recent legislation to allow "claims made" coverage and feel I know enough about the issue to know we do not want that, even though it promises lower premiums in the short term. Illinois may be considering exclusionary language- I object to this also or even

Page 2-

Senator Schuneman

an allegation made against a Center, however ridiculous and unfounded, could bankrupt a program were the cost of legal defense not a part of our insurance. Yet another proposal has been assigned risk pools and I still give this some weight as a possibility. I understand that the mere threat of doing this in California eased up the insurance crisis out there.

I am sure new ideas will come forth and perhaps a combination of several will be the solution.

I do hope you will be so kind as to keep me informed and call upon me if I can be of help. Thank you for taking an interest in this.

Sincerely,

Laurel Walker
Executive Director
cc: Rep. Joel Brunsvold
Senator Clarence Darrow
Day Care Action Council
DCFS -Sue Howell,
Cheif Office of Child Development

DAY CARE ACTION COUNCIL OF ILLINOIS

INSURANCE SURVEY--PRELIMINARY RESULTS

INSURANCE COMPANIES

Atlanta Mutual	2
Atlantic Mutual	3
American States	1
American Business Risk Services	3
Aetna	1
Avex	1
BMF Mission	1
Bituminous Causalty Fire and Marine	1
Community Insurance Center	1
Church Mutual	9
Continental Insurance	3
CHA Self Insured	5
Chicago State Self Insured	1
Corroon and Black Insurance Company	2
Cincinnati Insurance	3
City Colleges Self Insured	3
First Trust	26
First Illinois Risk Pool and Trust	13
First Illinois Religious and Charitable Risk Pool	1
Hartford Special Risk	1
Indiana Insurance	1
Industrial Insurance	2
INA	4
Insurance Corp. of Ireland	1
Insurance Risk Manager	2
Jefferson Insurance of New York	4
J. E. Simmons Insurance	2
Lindeman Associates and Maryland Casualty Company	1
Liberty Mutual	2
Merit Insurance Company	3
Midwestern Indemnity Company	1
Maryland Casualty	1
Mutual of Omaha	2
Midwest	1

National Casualty	1
Nationwide	2
Northeast Insurance Co.	2
National Indemnity Co.	2
National Union Fir Insurance of Pittsburgh	3
National Headstart Association -- Preschool Accident Program	1
Preferred Risk Mutual	11
Rush Presbyterian--St. Luke Medical Center	2
State Security	5
State Farm	7
Scottsdale Insurance	3
Salvation Army--Self Insured	
Shefield	1
Saracen	1
Travelers	3
USF&G Insurance Company	2
US Fidelity and Guaranty	5
West American	1

```
Distribution of locations
In Chicago                :                    67.11
In Chicago Metro          :                    11.18
A city other than Chicago:                     15.79
A rural area              :                     2.63

Single or multi site
Single :                 60.53
Multi  :                 32.89

Day care centers serving
Infants and/or Toddlers          :                    18.42
Preschoolers and/or school age:                       97.37

Do provide Transport     :                 24.34
Do not provide transport:                  69.74

Have been refused ins or increased:                     49.34
Have not been refused or increased:                     38.16

Average number of insurance claims                            :               1
Average # of claims for those sites with at least 1:                          3
Average liability limit:$        510,501                (Claim)
Average premium          :$        4,877
Average premium in Chicago                                  :            5958
Average premium in Metro (not including Chicago):                        2357
Average premium for other cities                            :            2924
Average premium for rural areas                             :             901

distribution of premiums
100-1999           :               0.50
   100 - 399       :               0.15
   400 - 799       :               0.15
   800 - 1199      :               0.12
  1200 - 1599      :               0.06
  1600 - 1999      :               0.03
2000-3999          :               0.18
4000-5999          :               0.10
6000-7999          :               0.09
8000-9999          :               0.03
more than 10000:                   0.09
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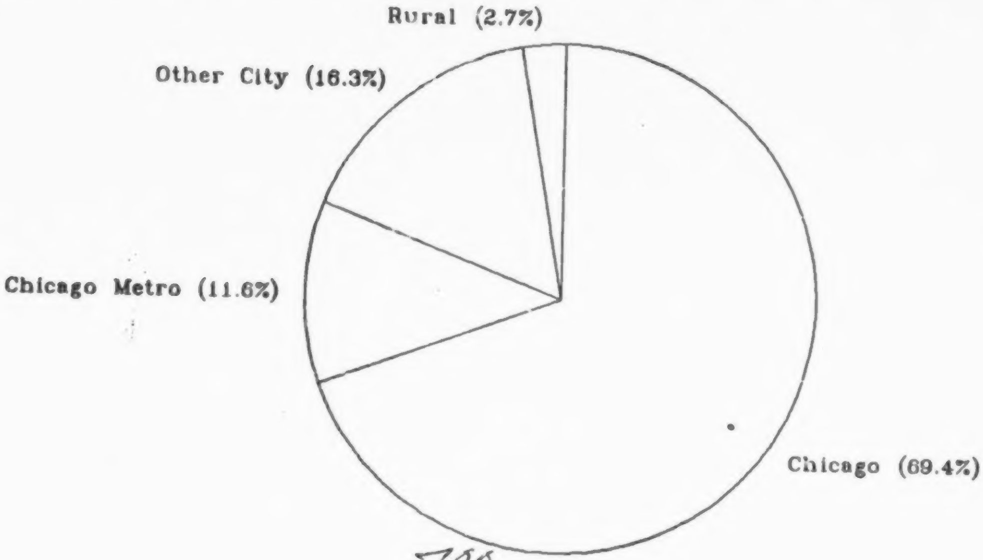
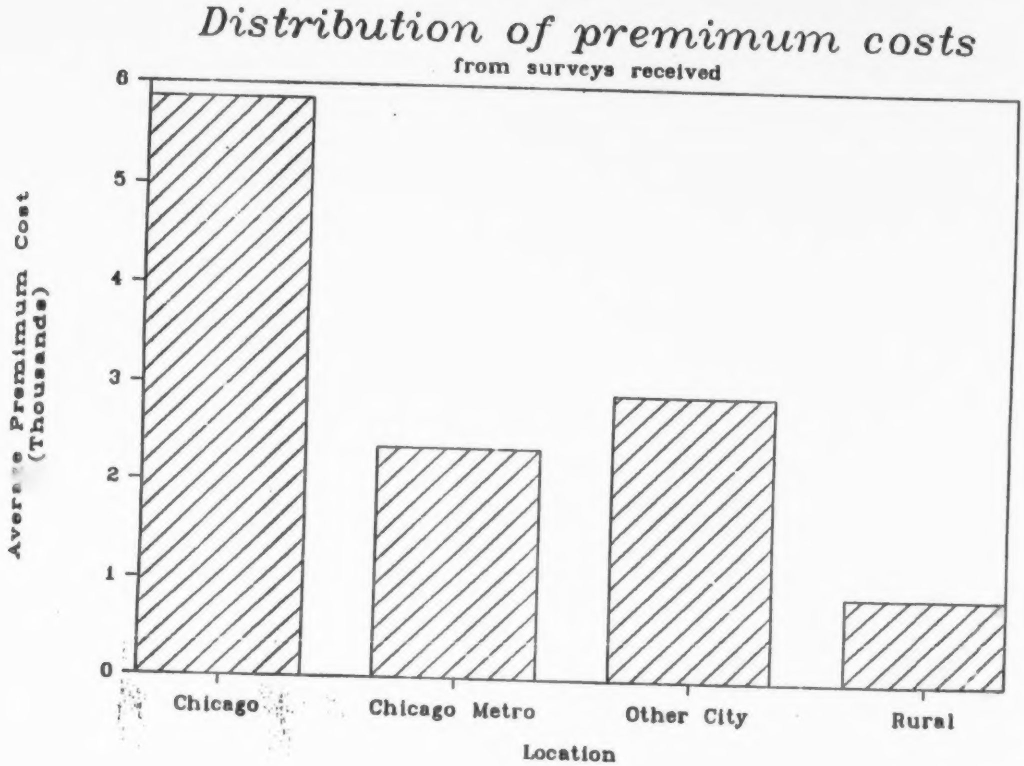
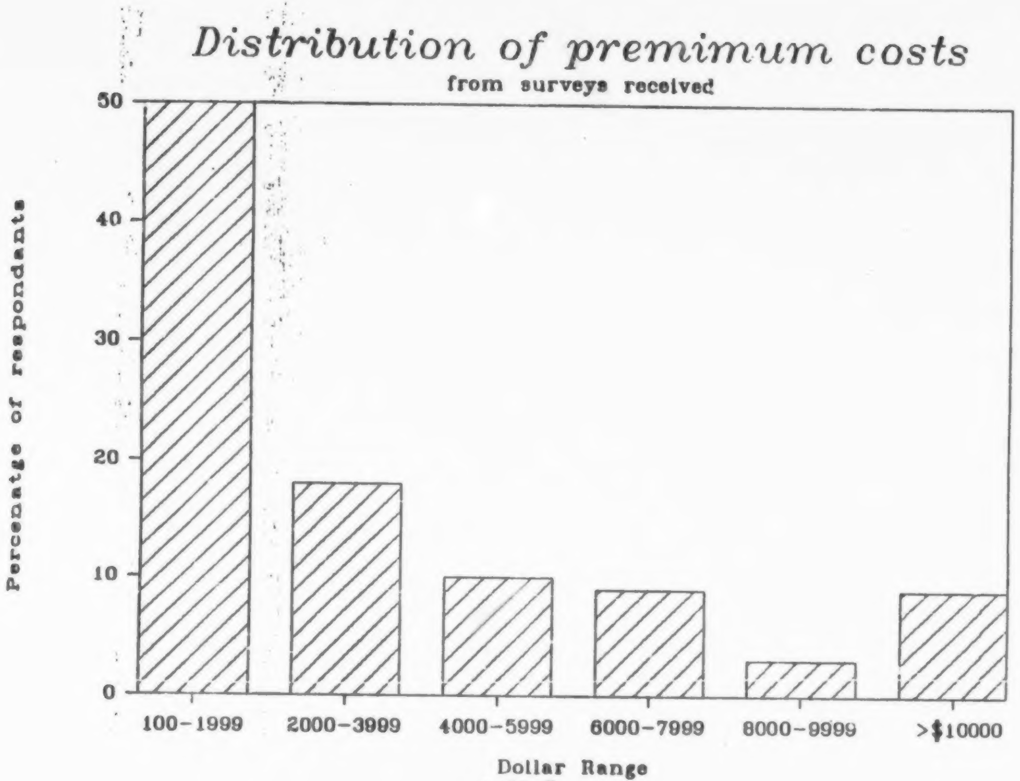
Distribution of Center Locations

from surveys received

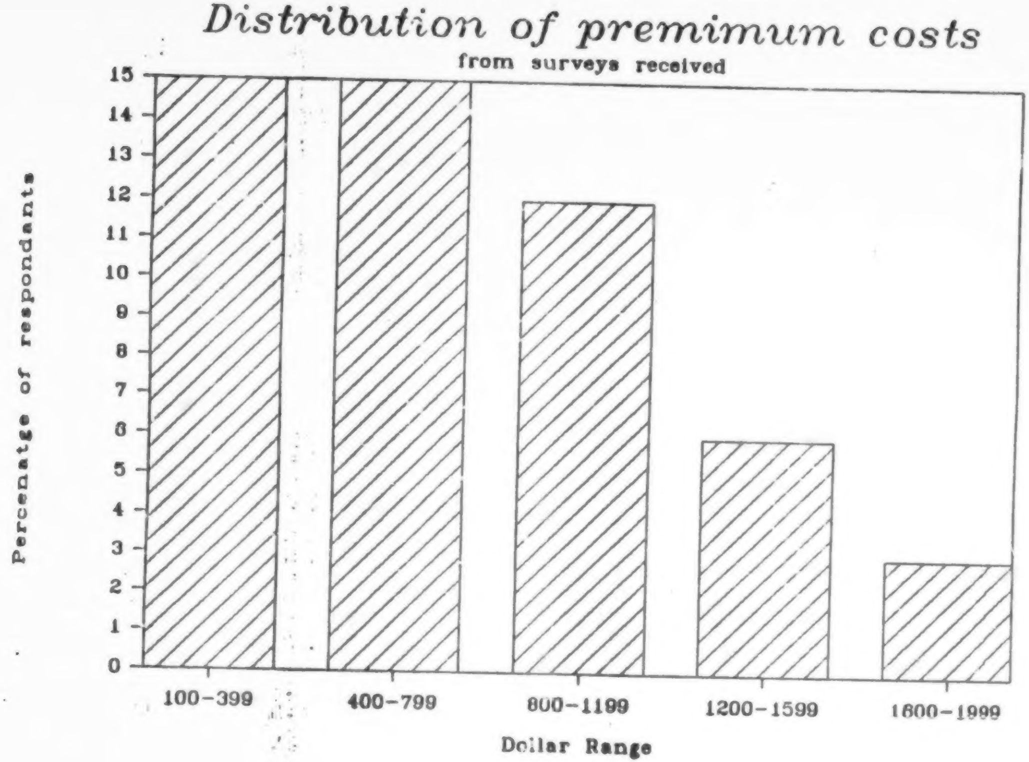




Distribution of premimum costs
from surveys received
Average Premimum Cost
(Thousands)
6
5
4
3
2
1
0
Chicago
Chicago Metro
Other City
Rural
Location


Distribution of premimum costs
from surveys received
Percenatge of respondants
50
40
30
20
10
0
100-1999
2000-3999
4000-5999
6000-7999
8000-9999
>$10000
Dollar Range

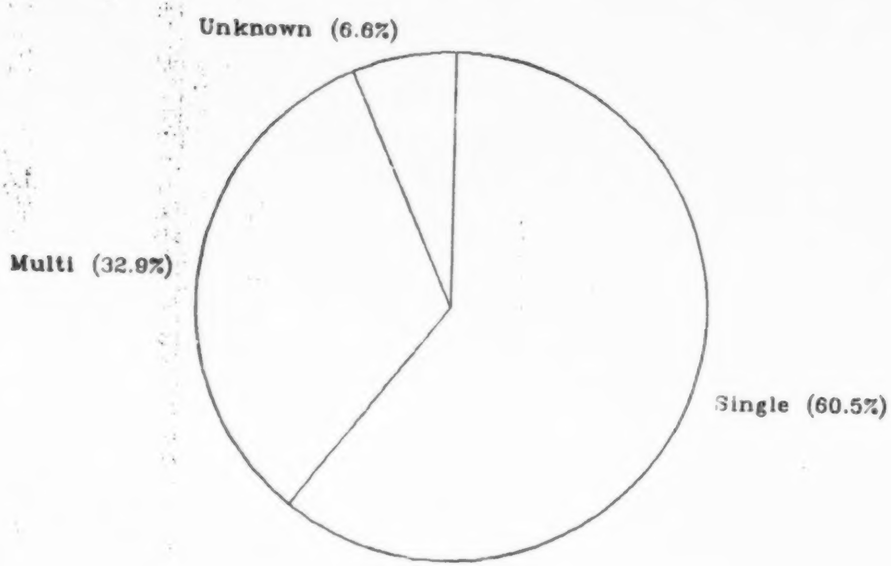
702


Distribution of premimum costs
from surveys received
Percenatge of respondants
0
1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
100-399
400-799
800-1199
1200-1599
1600-1999
Dollar Range

703

Single or Multi Site Center

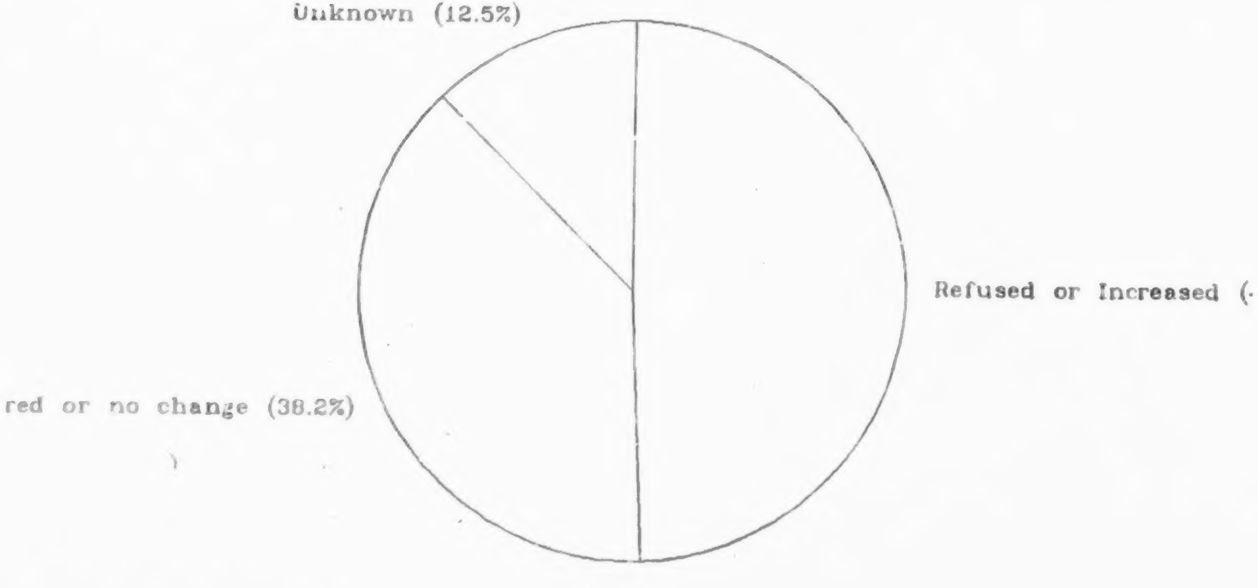
from surveys received



704

Refusal or increse in Insurance

from surveys received



United Way of Chicago
Insurance Task Force

Testimony Presented
to the House Insurance Task Force - February 6, 1986

In response to the growing national insurance crisis, the United Way of Chicago formed an Insurance Task Force in the fall of 1985 to assess the specific impact of rising insurance costs and problems of availability on voluntary nonprofit agencies providing human services in communities throughout Illinois. Members of the task force include directors of social service agencies and the United Ways of Illinois, Suburban Chicago, and Chicago, representing the entire range of human service programs, and officials from city, state and federal government agencies involved in the provision of human services.

Based on the work of the task force to date, a number of critical issues and problems have been identified which we feel are important to bring to your attention today. First, based on the results of the task force survey, nonprofit agencies are increasingly experiencing the same problems in affordability and availability of insurance coverage that have been reported for business and local government. Second, the problems of affordability and availability of adequate insurance coverage have a unique impact on nonprofit human service agencies, and the communities and clients we serve. And third, because of the extensive partnership which exists between state government and voluntary agencies for the provision of direct human services to Illinois citizens in need, the insurance crisis will have a direct impact on state government itself.

In the fall of 1985 the task force surveyed the insurance renewal experience of United Way member agencies in Chicago and a number of downstate communities. Key findings of the survey results for the 57 Chicago agencies who responded include the following. Based upon pre and post cost renewal information provided on 229 individual insurance policies, 200 (87%) of these policies were renewed in calendar 1985. Total pre renewal insurance costs were $2,318,188; post renewal costs were $3,416,927, resulting in a 50% net cost increase of $1,147,739. Percent increases for different types of insurance included: property up 37%; general liability up 31%; liability packages up 73%; automobile up 62%; and umbrella liability up 152%.

Fifty-six percent of the reporting agencies changed at least one carrier during their most recent renewal experience. Major reasons cited included refusal of adequate coverage (51%), search for better coverage (20%), and concern to lower costs (17%). Of those who changed, 67% reported difficulties in doing so. The major reason cited was problems finding a carrier who would provide adequate coverage (87%).

Additionally, 33% of the agencies that responded to the survey reported a reduction in coverage or an increase in the deductible. In these instances coverage was reduced by 50-80%, while deductibles rose from 100-500%. One agency reported being unable to renew umbrella coverage at any cost. In addition many day care centers reported serious problems in obtaining liability insurance without exclusions for sexual child abuse. Results from other communities in Illinois are currently being analyzed, but the preliminary data indicate similar findings to the Chicago experience.

It is important to note that these results are from 1985. One Chicago agency which just received its renewal quotation in January 1986 reported a 132% increase for its general liability policy and a 151% increase for its umbrella liability policy.

A further, and perhaps more serious implication of these findings, is that a significant portion of new charitable dollars raised in 1985 were in fact needed to pay for the 50% increase in insurance costs, rather than for expansion of critical human services for people in need.

These findings highlight our second major area of concern: the unique impact that the insurance crisis is having on voluntary human service agencies. In Illinois currently 200 independent United Ways provide more than $125 million in financial support annually to over 1,000 nonprofit human service agencies in communities throughout the state. United Ways and the agencies we support are governed by volunteer boards of directors, and the funds raised to support human service programs come from charitable contributions from concerned citizens and the local business community. Voluntary human service agencies exist because local concerned citizens have joined together to develop and support social services programs serving people in need without adequate resources of their own. Because we exist to serve the less fortunate, we cannot simply pass increased insurance costs on to the people we serve. We do not have the option, for example, of governments which have the power to raise taxes, or educational institutions which can raise tuitions. Thus, significant increases in insurance costs can only result in a direct reduction in services to people in need, or in cases where adequate coverage cannot be secured, the potential loss to the community of the service entirely.

Voluntary agencies, as well as business and government, need adequate insurance protection. As responsible agencies we must see that our clients, staff and volunteer boards are afforded this protection. The lack of adequate insurance protection can in fact endanger the entire voluntary agency structure by discouraging the very volunteer involvement that is central to our existence.

An additional problem facing voluntary agencies is the "difficult" type of clients our programs are designed to serve. Programs providing services to abused children, troubled adolescents, substance abusers, the physically and mentally disabled, and the frail elderly all serve client populations which have been viewed as "high risk" by the insurance industry. Yet, despite our "high risk" client population, there is no hard evidence that the actual claims experience of voluntary agencies warrants the rate increases and reductions in coverage human service agencies are experiencing.

Finally it should be noted that as government support for human service programs continues to decline and demands for service continue to grow on the voluntary sector, our capacity to meet these increased demands is being severely diminished by rapidly increasing insurance costs.

Our third area of concern relates specifically to state government. Current information indicates that statewide over 2,000 voluntary agencies provide upwards of half a billion dollars in services in partnerships with state government through departments such as the Dept. of Children and Family Services, Dept. of Mental Health and Development Disabilities, Dept. of Public Aid, Dept. of Rehabilitative Services, Dept. on Aging, and the Dept. of Public Health. State government has a responsibility to see that the human service agencies it contracts with have adequate insurance coverage for the protection of clients served, and to ensure the ability of the voluntary agencies to continue to participate in this service delivery partnership. Thus, the increased cost of insurance will have direct cost implications for state government, as rates paid for purchased services must reflect the real cost of providing those services. In addition, voluntary agencies unable to obtain adequate insurance coverage may well be forced to withdraw from this service delivery partnership, resulting in fewer resources available to state government for carrying out its mandated responsibilities and a further reduction in available services to Illinois citizens in need.

In conclusion, we recognize that the problems being experienced by the insurance industry are national, if not worldwide in scope, and that solutions are difficult and complex. We in the voluntary sector do not pretend to be experts in insurance, but we feel it is crucial that the particular effects of the insurance crisis on nonprofit human service agencies, our volunteers, and the clients and communities we serve be taken into account as a variety of solutions are explored, developed and implemented. The tens of thousands of Illinois citizens who volunteer their time, effort and money to support the current network of social service agencies, and the hundreds of thousands of Illinois citizens who benefit from the services offered each year deserve no less.

Thank you.

United Way
of Chicago

104 South Michigan Avenue
Chicago, Illinois 60603-5966
Phone (312) 580-2800

January 15, 1986

TO: Agency Executives

FROM: Preston B. Kavanagh
Chairman
Insurance Task Force

RE: Insurance Task Force Update

The Insurance Task Force, formed by the United Way of Chicago this fall to address the issue of affordable and adequate insurance coverage for voluntary agencies, has completed an analysis of the insurance renewal experience of United Way of Chicago member agencies. The Task Force is also exploring potential short- and long-term options to address the current conditions in the insurance industry and to help meet the insurance needs of voluntary social service agencies. This update provides information on four programs designed to assist agencies and organizations in obtaining coverage, identifies current state legislative actvities addressing this issue, and contains a summary of the results of the agency insurance survey. Future updates will provide information as additional developments occur. If you have any questions, please, contact Steve Bishop at 580-2807.

STATE INSURANCE PROGRAMS

1. Illinois Insurance Assistance Program

Insurance Type - Commercial Property and Casualty

Program Description - This is a new state program established by a coalition of Illinois property/casualty insurance industry under the auspices of the Illinois Department of Insurance. This program matches insurance applicants unable to obtain insurance coverage with appropriate commercial insurance companies. Applications for insurance are reviewed and referred to insurance companies with requests for coverage. Applicants must pay a $50 non-refundable fee.

Eligibility - Any agency or organization unable to obtain adequate property and casualty insurance from any source.

Coverage- Coverage is not guaranteed. Also, insurance companies may restrict coverage. For example, sexual abuse coverage in day care programs may be excluded.

Application - Applications are available and must be submitted through any licensed agent or broker. The responsible agents or brokers must certify that they have been unable to obtain insurance for their clients from any insurance company with whom they deal and must provide a letter of refusal from one insurance company that denied coverage along with the application.

2. Illinois Department of Insurance-Market Assistance Program

Insurance Type - Commercial Property and Casualty

Program Description - Program operated by the State Insurance Department to provide assistance to any agency or organization experiencing difficulty in obtaining insurance coverage. Upon request, the Department will attempt to identify an Illinois insurance carrier to provide the coverage. There is no fee for use of this service.

Eligibility - Any agency or organization having difficulty obtaining insurance coverage.

Coverage - Coverage is not guaranteed.

Rates - Policies are offered at regular commercial rates.

Application - Requests for assistance can be made directly to the Illinois Department of Insurance or through an agent or broker. Department of Insurance contacts are Joseph Schillaci, (312) 917-2420 or Jim Stevens, (217) 782-4515.

3. Illinois Automobile Insurance Plan

Insurance Type - Automobile

Program Description - This is an assigned risk program which guarantees auto insurance coverage by commercial insurance companies to individuals and organizations unable to meet their vehicle insurance needs through the regular commercial market.

Eligibility - Any agency or organization that cannot obtain vehicle insurance through the regular commercial market - for any portion of their vehicle insurance needs. Applicants must have been refused insurance in the regular market.

Coverage - Complete coverage for all vehicle needs is guaranteed. Coverage is for a 3 year period, after which applicants may reapply.

Rates - Rates tend to be somewhat higher than regular commercial rates.

Application - Applications may be submitted through any insurance agent or broker or through the Automobile Insurance Plan Service Office, 20 North Wacker Drive, Chicago, Illinois, (312) 346-1991.

4. Illinois Fair Plan

Insurance Type - Property and Casualty Homeowners
- Property for Commercial Buildings and Non-Owner Occupied Dwellings

Program Description - The Fair Plan is an association which functions like an insurance company in making homeowners and other property insurance available to people in specified urban areas who are not able to buy it through regular insurance markets. The Fair Plan is funded and supported by insurance companies doing business in Illinois.

Eligibility - Any property owners in designated urban areas that cannot obtain insurance through the regular commercial market. All property owners within Chicago city limits are eligible.

Coverage - Coverage is not guaranteed. Applicants must meet the Fair Plan's underwriting standards.

Rates - Rates tend to be somewhat higher than regular commercial rates.

Application - Applications may be submitted through an insurance agent or broker or through the Illinois Fair Plan Association, 332 South Michigan Avenue, Chicago, Illinois, (312) 427-9614. Proof must be furnished that the applicant was denied requests for insurance coverage three times in the regular commercial market.

STATE LEGISLATIVE ACTIVITIES

The Illinois General Assembly approved three pieces of legislation related to the current insurance crisis during the recent fall veto session. Senate Bill 907, signed into law on October 31, 1985, is designed to prevent mid-term cancellation of casualty policies without proper justification. Conditions under which a policy may be cancelled include non-payment of premiums, misrepresentation, violation of terms, certification of the loss of reinsurance by the insurer, and a substantial increase in risk.

Senate Resolution 499 establishes a Senate Select Committee to hold hearings to investigate the problems of availability and affordability of insurance coverage. Members of the Committee are:

Tim Degnan, Chairman, (D. District #11, Chicago)
Emil Jones, (D. District #17, Chicago)
Joyce Holmberg, (D. District #34, Rockford)
Greg Zito, (D. District #26, Melrose Park)
Art Berman, (D. District #2, Evanston, Chicago)
Margaret Smith, (D. District #12, Chicago)
James Rupp, Minority Spokesperson, (R. District #51, Decatur)
Calvin Schunenan, (R. District #37, Prophetstown, Whiteside, Co.)

Judy Barr Topinka, (R. District #22, Berwyn)
Frank Watson, (R. District #55, Caryle-Clinton Co.)
William Maker, (R. District #19, Homewood)
John Friedland, (R. District #33, South Elgin)

House Resolution 831 establishes a twenty member House Task Force to completely analyze and study the affordability and availability of insurance coverage. The members of the House Task Force have not as yet been appointed.

In addition, a number of bills proposing state gegulation of insurance rate setting, expansion of the Fair Plan, and tort reform are in the process of being drafted and introduced into the General Assembly for consideration in the 1986 legislative session.

RESULTS OF MEMBER AGENCY INSURANCE SURVEY

The 57 United Way of Chicago member agencies responding to the insurance survey identified a net cost increase of $1,147,739 at their most recent renewal experience. The reported 50% average increase in insurance costs indicates that a significant portion of new monies raised by the United Way and the agencies themselves was needed to offset the insurance increases rather than for the direct provision of human services. The enclosed report provides a summary of the key findings of the survey.

UNITED WAY OF CHICAGO MEMBER AGENCY INSURANCE SURVEY - SUMMARY OF FINDINGS

The summary is based on information provided by the 57 member agencies who responded.

Of the 229 policies for which pre- and post renewal cost information was provided, 200 (87%) reported policy renewals in calendar 1985. Total pre-renewal insurance costs were $2,318,188; post renewal costs were $3,416,927, resulting in a net cost increase of $1,147,739 (50%). Percent increases for different types of insurance ranged from 5% for accident to 152% for umbrella policies. Increases of over 30% were reported for property, liability, liability packages, umbrella, automobile and bonding.

Fifty-six percent of the reporting agencies changed at least one carrier during their most recent renewal experience. Major reasons cited included refusal of adequate coverage (51%), search for better coverage (20%), and concern to lower costs (17%). Of those who changed, 67% reported difficulties in doing so. The major reason cited (87%) was problems finding a carrier who would provide adequate coverage. Additionally, 33% of the agencies reported a reduction in coverage or an increase in the deductible.

NARRATIVE QUESTION SUMMARY

Over half (56%) of the 57 reporting agencies changed at least one carrier during their most recent renewal experience. Reasons cited for making a change included:

- carriers' refusals of adequate coverage (51%);
- search for better coverage (20%);
- concern to lower costs (17%); and
- carriers' decision to go out of business (10%).

Changes in carriers were the most common for the following types of insurance:

- general liability (22%);
- workmen's compensation (15%); and
- umbrella (13%).

Of the agencies that changed carriers, 67% reported difficulties in doing so. The major reason cited in 87% of the cases was problems finding a carrier who would provide adequate coverage. Another reason cited was high costs.

Furthermore, 33% of the agencies reported a reduction in coverage or an increase in the deductible - mostly associated with general liability (37%) and umbrella (32%). In these instances, coverage was reduced by 50% to 80% while deductibles rose generally from 100% to 500%. One agency reported being unable to renew umbrella coverage at any cost.

Concerning whether insurance coverage difficulties were associated with the nature of the agencies' work, over half (59%) of the reported reasons indicated this to be the case. Day care and child related services accounted for almost half of the instances cited. In particular, day care centers reported problems obtaining insurance without exclusions for sexual abuse coverage.

PRE- AND POST RENEWAL COST COMPARISON BY TYPE OF INSURANCE

Type Of Insurance	Number Of Policies	Pre-Renewal Cost of Insurance Total	Post Renewal Cost of Insurance Total	Dollar Increase	Per Cent Increase
Property	25	$ 333,899	$ 457,540	$ 123,641	37%
General Liability	14	232,627	304,677	72,050	31
Liability Packages 1/	43	515,417	892,104	376,687	73
Board and Officer Liability	22	74,647	81,309	6,662	9
Umbrella	11	110,680	278,922	168,242	152
Automobile	18	174,220	281,659	107,439	62
Accident	13	21,359	22,505	1,146	5
Workmen's Compensation	55	768,420	929,594	161,174	21
Bonding	23	17,206	22,852	5,646	33
Other 2/	5	8,713	9,765	1,052	12
Total:	229	$2,257,188	$3,280,927	$1,023,739	45
Total: Two Agencies with Cost Only		61,000	185,000	124,000	203
TOTAL FOR 57 AGENCIES:		$2,318,188	$3,465,927	$1,147,739	50%

1/ Liability Packages include general liability policies reported in combinations with property, accident, auto, crime, inland marine, fire, professional liability, board and officer liability, and social workers' liability.

2/ Not Identified

Left uncovered

Day care insurance skyrockets-or disappears

By STEVE MILLS
Correspondent

IN THE WAKE of allegations of sexual misconduct in preschools and day-care centers around the country, school owners are facing a battle with insurance companies that may force the schools to close their doors.

The battle centers on the dwindling number of insurance companies offering liability coverage to preschools. In many cases, the insurance companies are doubling and tripling the annual premiums they charge.

In other cases, insurance companies are simply getting out of the preschool insurance business, leaving many preschool owners in search of coverage and faced with the possibility of closing.

"**THE RATES** have skyrocketed," said Phyllis Cannon, co-owner of Kiddie Kollege, 6025 N. California Av. "They're making it impossible [illegible]

how to react to strange situations and unfamiliar people. He said the program would consist of three 10-minute session per week.

"Insurance companies are raising rates on the basis of what could happen," he said. "They've been convinced by the few horror stories on TV and in the papers."

"**THE TRUTH** of the matter," said Tom Teague, a spokesman for the state's Department of Children and Family Services is that a child is less likely to be abused at a day-care center than at home," Teague said. "Children are quite safe at day-care centers. One reason for that is because the centers are licensed by the state and must maintain certain standards."

WILLIAM F. Buell, whose Libertyville-based insurance agency used to handle almost 90 preschools, said the publicity generated by recent sexual abuse cases scared away many companies.

"No one has ever wanted to in- [illegible] Buell said.

chool insurance because they have been unable to get underwriters to reinsure them and share the burden of claims.

Len Wilde, president of the preschool owners association, said the association owners want a large company to insure them.

"We want an insurance company to sit down with us and write something out for both our benefits," Wilde said. "We could deliver a great number of schools.

"The loss ratios that we are aware of just don't bear out the concern."

ONE AREA where preschool owners and insurance companies agree is in the treatment of unlicensed preschools. According to a 1983 law, church-, park- and Montessori schools are exempt from licensing and do not have to meet the standards of licensed schools.

School owners say their costs are increased because of state regulations, forcing them to set tuition rates that do not compete with those of unlicensed schools. Insurance companies say they fear unlicensed schools do not maintain adequate standards.

"Just because it is a religious organization, it doesn't make the workers proper people," Kiddie Kollege owner Cannon said. "Everyone should be licensed, at least for the children's safety. You can't have laws for one group and not for the other."

Cannon, who maintains an open-door policy to allow parents to visit the school at any time, says she has noticed parents are more careful with their children.

"The child care act," Busy Beaver School owner Fitzgerald said, "says it is to protect all children, but it doesn't. It is a case of selective enforcement."

715

Cannon, whose school is licensed by the state to accommodate 76 students, said her rates have risen to about $1,700 per year from $600 per year, a nearly 300 percent increase. Cannon said she thought the publicity surrounding recent sexual abuse cases had given insurance companies a reason to raise their premiums.

"The publicity was just an opportunity for them to raise their rates," she said.

Cannon said her tuition has remained at $55 per week per student for three years. She said she is closely monitoring nearby schools to see if they are increasing their rates .

"As soon as the others go up, I'll go up."

MIKE FITZGERALD, owner of the Busy Beaver Nursery School at 1329 W. Loyola Ave., said his insurance rates have gone from $1,400 to $2,300.

"I was lucky to get that," Fitzgerald said. He is developing what he calls an urban kids survival program, to teach his students

"They have never been popular. When they have claims, they're big And now, They're trying to tell us insurance isn't available. They just don't want to pay for it."

Buell said recent rate increases are more a result of insurance companies trying to make up for lower-than-normal rates over the last decade. He said he also fears future court decisions will allow a person to sue an insurance company for abuse that occurred as a child.

"It's a unknown quanitity," Buell said. "You never know what a child is going to say."

LEN JOHNSON, a broker for the Russell Hummel co., which now insures two preschools, said his company is trying to work a deal to insure the approximately 200 members of the Preschool Owners Association of Illinois.

"We are trying to become more active in it," Johnson said. "It's a simple matter of a bad market condition."

OPINION

Insuring sound change

Childhood is such a brief period in life that it is understandable when parents, school and recreation officials demand immediate action to remedy a situation they see threatening a youth's opportunities.

Problems in obtaining insurance coverage for school and park system athletic programs, and the cost of premiums for such coverage, have become the emotional cutting edge for cries that something must be done to reform insurance coverage in Illinois. Reports of huge increases in premium costs for general school and municipal coverage and for many businesses also have fueled the demands for reform. Now, Republican Gov. James Thompson and elected leaders from both parties facing re-election have taken to billing 1986 as the year for reform of Illinois insurance practices.

The insurance battle pits two powerful special interest groups, trial lawyers and insurance companies, against one another. Insurance company spokesman advocate placing caps on damage awards, limiting the size of fees plaintiffs' lawyers can collect, and revising tort law to reduce liability in situations where there are a number of defendants or where the plaintiff may be mostly at fault.

Trial lawyers have, in turn, called for state regulation of the insurance industry and state-required approval of rate increases. Each side paints the other as profiting immensely from the current system of insurance rate setting and jury awards. In many ways, each side is right about the other. The situation should make all of us wary about an insurance reform based on debate over who deserves a larger slice of the public's hide.

An obvious fact about the state of the insurance industry in Illinois is that, because the industry is largely unregulated, little good overall data on its operations exist. Lawyers like to point to average claim settlements of $1,100 in Missouri to prove that the current system does not condone unjustified payments. Insurance spokesmen prefer to single out enormous jury awards and bizarre cases like the one in California where a plaintiff collected from a phone booth manufacturer after the phone booth he was in was hit by a drunk driver.

The year 1986 may not be the year for sweeping insurance reform in Illinois. Many of the immediate problems involving athletic programs, school and government insurance coverage have been resolved temporarily, albeit at substantial cost. What is needed now is legislation requiring full reporting by insurance companies to the Illinois Insurance Dept. on how their rate structures are set in Illinois and how insurance company profits or losses are determined. Before the state can decide whether an industry needs to be regulated, it needs some idea of whether such regulation will improve that industry's service to the public.

If the information that comes in to the state on liability insurance rate structuring indicates the need for tort reform, or for greater control of the insurance industry, perhaps 1987 would be the year to consider it.

Two relatively minor legislative changes should be made by the General Assembly in 1986. One is to require insurance companies to give 90 days notice of their decision not to renew an insurance policy, rather than the current 30-day period. Another is to make it easier for local municipalities and schools to form their own insurance pools. These steps, combined with better data reporting to the Illinois Insurance Dept., make more sense than rushing into full-scale industry regulation or reform of standards for establishing legal liability.

These changes don't make headline-grabbing politics, just good sense.

Senator **Pressler**. Thank you very much.

Let me ask you both if you could very briefly summarize your views on this question: Is expansion of the Risk Retention Act going to address the insurance problems faced by small businesses?

Mr. **Bowman**. I think the problems go beyond the Risk Retention Act. I would not rule out the possibility it will address some of the problems, but I think the problems go much beyond that.

Senator **Pressler**. There will be some small companies that wouldn't be inside a group, for example.

Mr. **Bowman**. Yes.

Mr. **Muhl**. It is just my personal observation that any time you create an alternative mechanism, any time that you would, let's say, for municipalities or others or even small businesses, go into a pooling arrangement, unless you change the cause of some of the problems, all you are doing then is just merely shifting the burden of payment. If you are involved in a situation where you allow groups to go under certain umbrellas, unless you change the rules of their exposure, then all you are doing is just changing the payment mechanism and not solving the concern of the problem.

Senator **Pressler**. Several witnesses have questioned the fairness of insurance company rate making and pricing practices. Do you feel this practice can be adequately regulated through the efforts of the individual States, or do you think the Federal Government will have to get involved?

Mr. **Muhl**. If I may just respond to that, I think the States are quite capable of handling that aspect for a number of reasons. When you discuss whether it should be a Federal issue or a State issue, I suggest to you that I feel very strongly that it could be and should be a State issue.

We have throughout the United States a lot of different department personnel. I think I put in my testimony we have some 6,000 in the various departments, and we extend through budget and expense of over $200 million to regulate the insurance industry. It varies by State as to the amount of regulatory controls and as to what kind of regulatory controls, but I think that is one of the strengths of the system of State regulation, because the problems that I am experiencing, for example, in the State of Maryland as to our citizens may not be the same problems and concerns experienced in California or Illinois or Texas.

So, the solutions to those problems, because we are not experiencing either the same or the same degree of severity of the same problem, we can mold, if you will, the solutions to the best interests of our citizens. I think State regulation works far better in that situation and not applying one fast and strong universal rule throughout.

Mr. **Bowman**. I and the NCSL endorse Mr. Muhl's response to your question.

I would add just one personal observation that I think a greater threat to fairness arises from sort of a piecemeal approach to trying to deal with the problems such as, for example, special legislation regarding medical malpractice or perhaps other lines of insurance, because you may very well wind up with a situation where you have two individuals who have suffered the same injury where there is clearly negligence that has been identified, and leaving aside questions of joint and several liability on the part of the tort feasors, perhaps receiving different kinds of remedies and relief from the system, depending on the origin of the injury, whether it was a surgeon's scalpel or whether it was a next door neighbor or whether it was a dram shop.

I think that poses a greater threat to fairness.

Senator **Pressler**. So, to summarize, both of you feel that the Federal Government should take a very limited role legislatively in resolving this problem. Is that right?

Mr. **Muhl**. Yes. I would suggest that, because I think the States are capable of responding to particularly this crisis that we are faced with. As I indicated in the testimony, Senator, there are a lot of things that the States have done. I would also suggest that Mr. Bowman alluded to a lot of those.

We have attacked the problems, we have addressed the problems, and we have thus far supplied a lot of the solutions, not all of them, absolutely not all of them. But we have gone a long way in resolving a lot of the specific concerns, and I think the States are quite capable of doing that.

In the event, though, that we are unable to change some of those things that need to be changed on a State level, such as when we talk about the tort system, that is not the whole of the problem; that is only a part of the problem. As I indicated earlier, the insurance industry is part of the problem as well, but we have to attack the situation where we can.

When you are dealing with the inability of an insurance industry, in one instance, to predict their loss, to properly price the product that they are selling, then we have to change that rule. I refer to for an example a lot of the decisions that are being made are taking existing contracts that are narrowly defined contracts and broadening the coverage. That was never intended nor contemplated initially, particularly where a premium was not collected initially. That is broadening that scope to now where the insurance company has a greater exposure than they ever anticipated initially.

We have to bring that system back to some stability. I think the States are capable of doing that, but in the event that there isn't a degree of uniformity throughout the States to return that stability, then that is an area where you may want to consider involvement.

Mr. **Bowman**. Mr. Chairman, I absolutely agree with that.

Senator **Pressler**. Good. I believe that concludes our hearing, unless there is some business I haven't tended to here.

Mr. **Muhl**. Thank you, Mr. Chairman.

Senator **Pressler**. Thank you. That concludes our hearing, and we will stand adjourned.

[Whereupon, at 11:30 a.m., the committee recessed, to reconvene subject to the call of the Chair.]

APPENDIX

TELTEX INC.

February 18, 1986

Ms. Tracy Crowley
Committee on Small Business
U. S. Senate
428A Russell Building
Washington, DC 20510

Dear Ms. Crowley:

I understand you are the person to whom we should channel our comments about the insurance liability problems for small businesses.

There are two areas that are affecting us, and I believe that both could be solved by legislation without hurting the insurance industry, manufacturers, or potential injured parties in the future.

The first problem is that insurance is not available regardless of prior record, and when available the cost is so prohibitive that small businesses generally cannot afford the coverage. Large businesses do not have this problem because they can either be self-insuring, or pay such large premiums on property and other insurance that the liability coverage is provided to them as part of a package.

The second problem is that some kind of a limit must be established to the damages that can be awarded to an injured party. Unless there is some type of negligence, malicious intent, or similar activity, the injured party should not be able to collect millions of dollars because of an accident, or the use of some product.

This problem is one that requires a solution immediately, not years down the road, as its impact is immediate and severe on all small businesses.

Sincerely,

Mat Bockh

COMMERCE DRIVE • NORTH BRANFORD, CT 06471 USA • TELEPHONE: (203) 481-5588 • TELEX: 956040

Illinois Petroleum Marketers Association
P.O. BOX 1508 ■ 112 WEST COOK STREET, SPRINGFIELD ILLINOIS 62705 ■ PHONE (AC 217) 544-4609

WILLIAM R. DEUTSCH
EXECUTIVE VICE PRESIDENT

STATEMENT OF THE ILLINOIS PETROLEUM MARKETERS ASSOCIATION
ON PROPERTY AND CASUALTY LIABILITY INSURANCE
BEFORE THE
U.S. SENATE COMMITTEE ON SMALL BUSINESS

HONORABLE LOWELL P. WEICKER, JR.
CHAIRMAN

FEBRUARY 26, 1986

Submitted by:

Illinois Petroleum Marketers Association
William R. Deutsch, Executive Vice President
112 West Cook Street
Springfield, IL 62704

(217) 544-4609

TESTIMONY

Chairman Weicker:

On behalf of the membership of the Illinois Petroleum Marketers Association, I would like to express my deep appreciation for the opportunity to speak at this hearing. The Illinois Petroleum Marketers Association has over 750 members, independent businessmen operating as jobbers, marketers and suppliers of petroleum products in every county in the State of Illinois. Their operations vary in size from as small as 300,000 gallons a year to some as large as 70,000,000 gallons a year. Many of these jobbers operate under branded names, others operate under their own independent name and therefore, provide views of both the branded and unbranded segment of the petroleum marketing industry in the State of Illinois.

Many of our members are small jobbers or marketers, owning tank wagons, pick-up trucks, and using common carriers for the transportation of petroleum products. However, 40 percent of our jobbers also own transports and pick up the product at refineries and terminals throughout Illinois and adjoining states, and transport the product to their bulk plants or directly to service stations or large commercial accounts. The jobbers deliver 80 percent of the agriculture demands for gasoline, fuel oil and diesel fuel. They also serve a large percentage of industrial users.

Eighty-five percent of Illinois Petroleum Marketers own or operate service stations. Today, 50 percent are self-service, and the other 50 percent are full-service or dealer operated. Several other IPMA members either operate or own over 80 truck stops in Illinois. In addition, in the last five years, many have entered food operations in conjunction with service stations. These operations are known as convenience stores.

Insurance has become one of the most serious and threatening problems facing our industry. In fact, only the petroleum shortages of 1973-1974 and 1978 have had a greater negative impact on petroleum marketing and the transportation of petroleum products. Since 1980, property and casualty insurance in the petroleum industry like many other industries has changed dramatically. During the period of 1981 through 1984, the premiums dropped as insurance companies fought for the business and dollar volume, so they could reinvest premiums at the high interest rates being paid by the financial institutions. In early 1985, there was a tightening of property and casualty insurance. Our association has dealt primarily with two companies — Federated Insurance Company of Owatonna, Minnesota and Frank B. Hall & Company of St. Louis, Missouri, brokers for Commercial Union Insurance. Frank B. Hall & Co. informed IPMA in late 1984 that they were switching from Commercial Union to the Traveler's Insurance of Hartford, Connecticut. IPMA has also worked with Ranger Insurance of Dallas, Texas and individual members were doing business with approximately twenty other companies licensed in Illinois. (See Exhibit A)

The major problem existing for petroleum marketers is finding another insurance company when their policies are cancelled or renewed with substantial premium increase. Presently the choices are Federated Insurance, Frank B. Hall & Co. representing Traveler's, Farmland Insurance owned by Nationwide, A.R.M. representing Reliance Companies, and Ranger Insurance where in a few isolated cases, they have renewed policies, but have written no new business. The Planning Corporation is strictly pollution policy. Recently Millers Mutual has written a few policies. Roughly five companies are writing property and casualty insurance for the entire State of Illinois. On a national level, there are an additional three companies. The impact of this funneling down process makes it practically impossible to find insurance coverage even with Illinois Department of Insurance's 60 day notice of cancellation requirement.

Of the above mentioned companies, Federated Insurance has recently initiated fees of $550 per location for unprotected tanks, $250 per location for fiberglass and protected tanks, and a $200 surcharge for tanks over 12 years old. Federated has separated the pollution coverage from the general policy at no reduction in premium and will pay claims on a "claims made" basis. The Planning Corporation, in August 1985, agreed to provide insurance for members of IPMA but, as of this date, have not provided us with any forms. They blame this situation on the loss of reinsurance. The remaining companies are writing policies on a very limited basis with extremely high premiums with no pollution coverage.

At the same time, the companies who are writing insurance have increased rates from 40 to 300 percent. The average increase is around 60 percent. During the first two weeks of February, IPMA conducted an up-to-date survey of our membership. The figures obtained indicate that many petroleum marketers (small businessmen) may be forced into bankruptcy or required to liquidate their businesses if they cannot get proper insurance coverage. This survey does not include any major oil companies. In most cases, major oil companies are self-insured except for catastrophic losses.

The State and Federal EPA need to re-evaluate their stance on underground tanks and the potential leak problems associated with these tanks. IPMA has been monitoring propaganda sent out by various insurance companies. Most companies indicate they will be charging a premium of $200 for tanks which are 15 years and over that are not fiberglassed or catalytic protected. In one instance a company conducted a survey on 12,863 tanks and obtained the following statistics: (See Exhibit B)

TOTAL TANKS SURVEYED - 12,863

1. 12,150, or 94.4%, are steel, unprotected tanks
   - A. 5,522 of these, or 45%, are 16 years old or older
   - B. 2,975 of these, or 25%, are 10-15 years of age
   - C. 3,653 of these, or 30%, are 0-9 years of age
2. 259 are steel-epoxy (e.g. fiberglass) lined
3. 221 are STI-P3 tanks (catalytic protected)
4. 233 are fiberglass tanks

The Illinois State Fire Marshal's Office indicates there were approximately 182 reports of leaking petroleum tanks in the past year. (See Exhibit C) Over 60 percent were caused by inferior work on the piping. The use of Japanese plastic pipe which is not compatible with U.S. pipe has been one of the major problems. This could be eliminated by forcing the installers of underground storage tanks to be licensed by the State and Federal Government. The people installing such tanks would be required to take a test to make sure that they have the knowledge needed to install underground storage tanks for petroleum products. Furthermore, IPMA has checked with the two largest carriers of property and liability insurance in the state and found the following information pertaining to claims that occurred in Illinois:

- Federated Insurance had one tank leak liability in 1981, 1982, and 1983. In 1984, there were two claims. Total amount paid or reserved for these five claims were $63,125. On site pollution clean up took one claim in 1983 and one in 1984. The total paid for these claims was $13,764. This is coverage for clean up on the premises of the marketer where no liability has occurred for damage to other property.
- Frank B. Hall & Co. stated that from 1980 - 1984, their claims were so few that they did not even keep track.

This disputes what the press and the EPA have been saying about Illinois having a large problem and a tremendous number of leaks. Perhaps what started this hysteria was a segment of 60 Minutes, the CBS program, that aired about two years ago dealing with a leak problem in Rhode Island. This was blown completely out of proportion and made the American public believe that there were a substantial number of underground storage tank leaks. This is not true, especially here in Illinois. The public should be made aware of the true facts.

Something must also be done in our Court Systems to prevent judges and juries from handing down exorbitant awards for liability claims, both in underground pollution and for crimes committed during hold ups in convenience stores. The Illinois Insurance Information Service should be forced to update their rate structure. Illinois is still one of the few states that does not have a different insurance rate for full service stations compared to self service stations. At full service, people on duty work on automobiles and also use lifts. At self service, there is merely a person in the kiosk acting as cashier, in most cases behind burglar proof glass which protects from robberies. Yet the Illinois Insurance Information Service has repeatedly refused to change workman's compensation rates like most of the other states in the union. Their thinking is archaic and certainly needs to be upgraded. The awards some juries and judges have given on workmen's comp and pollution liability have been notoriously high.

Naturally the insurance companies have become very gun shy and have readily admitted they are increasing rates to protect themselves from the possibility of huge settlements from pollution damages. There have been very few claims experienced , yet petroleum marketers are being forced to pay high insurance rates on the probability/ possibility of being forced to pay claims awarded by the courts. At a meeting last February in Washington, D.C., the insurance companies readily admitted they had no big losses from petroleum marketers, yet their worry was that if there was a pollution liability case where a tank leaked, the courts would award such a huge sum that they must have the reserves available. They also were quick to point out they were badly burned financially by the Union Carbide disaster in India in the fall of 1984. The losses sustained had to be recovered.

Remember, the Illinois State Fire Marshal's Office, starting in 1928, and especially since the late 1940's, has required that before any petroleum tank can be installed in Illinois, plans first must be approved by the State Fire Marshal's office. A Fire Marshal must be on hand when the tank is buried to see that it is done properly. This has helped to reduce the number of leaks tremendously. The Fire Marshal's Office is to be commended for the work it has done.

IPMA's recommendations to you are as follows:

1. Review of McCarran-Ferguson Act.
2. Create Federal Office of Insurance Information.
3. Repeal insurance exemption under F.T.C. jurisdiction.
4. Expand Risk Retention Act (Self-insurance).
5. National re-insurance program for liability and casualty funded by insurance industry of United States.
6. Limit amount of awards and attorney's fees.

EXHIBIT A

COMPANIES NO LONGER WRITING OR RENEWING PROPERTY AND CASUALTY INSURANCE AS OF FEBRUARY 1, 1985

1. American States
2. Aetna
3. Commercial Union
4. Fireman's Fund
5. North Brook
6. St. Paul
7. Ohio Casualty
8. Northwestern
9. Hanover
10. The Home
11. Continental
12. Ranger
13. Transamerica
14. INA
15. Hartford
16. Maryland Casualty
17. Cincinnati
18. Zurick

In a very small number of isolated cases, some policies have been renewed by these companies.

FEDERATED INSURANCE

UNDERGROUND TANK EVALUATION

Underground storage tanks continue to be one of the biggest challenges and headaches for the oil industry and their insurers. Federated's response to the underground tank dilemma has been to continue to make insurance available and to conduct a survey of our policyholders.

Federated has hired an environmental service firm, as well as using their own loss control personnel to survey each insured service station or convenience store that has underground tanks. The survey is for purposes of education, safety, loss prevention, and pricing information. The survey was Federated's attempt to be solution conscious, rather than simply problem conscious.

As you are well aware there are fewer and fewer insurance companies available in this marketplace and we felt this was a legitimate response to the tank leakage dilemma.

Preliminary results are now available from this survey. These results reflect 1289 policyholders, encompassing 3186 locations and totalling 12,863 tanks. 66.6% of these tanks are jobber owned and operated, 24.1% are jobber leased, .4% were owned by a major oil company, and 8.6% were independently owned and operated.

Interestingly enough, inventory control recommendations were made in 56.3% of the locations surveyed. These recommendations would normally have been:

A. Daily stick measurements of the product in each tank with these reading reconciled with the pump meter reading and/or

B. Daily records of the stick reading and the opening and closing pump meter reading and any difference between these two methods.

Monitoring devices or other tank upgrading measures were recommended in 51% of the locations.

We recommended a weekly water check in 47% of the cases. The recommendation was made for inventory record retention in 23.6% of the cases. Proper care of empty and abandoned tanks was made in 5.6%

Our information on tanks is as follows:

Total Tanks Surveyed - 12,863

1. 12,150, or 94.4%, are steel, unprotected tanks
    A. 5,522 of these, or 45%, are 16 years old or older
    B. 2,975 of these, or 25%, are 10-15 years of age
    C. 3,653 of these, or 30%, are 0-9 years of age
2. 259 are steel-epoxy (e.g. fiberglass) lined
3. 221 are STI-P3 tanks
4. 233 are fiberglass tanks

These are preliminary results of the survey and we hope the information is helpful to the petroleum industry in evaluating the underground tank problem and possible solutions to the problem.

```
REPO#1 NMBR     *** UNDERGROUND TANK EVALUATION OF LOCATIONS ***
 UOP310                 FEDERATED MUTUAL INSURANCE CO                    DATE
                                                                         01JAN00 July 31, 1985
                DATA ANALYZED FOR STATE: ALL     ;(ALL STATES)

                            GENERAL INFORMATION

NUMBER OF POLICYHOLDERS                         :   1628
NUMBER OF LOCATIONS                             :   5043
NUMBER OF TANKS                                 :  19371
AVERAGE NUMBER OF LOCATIONS PER POLICYHOLDER:         3.0976
AVERAGE NUMBER OF TANKS PER LOCATION            :     3.8411

LOCATION AVERAGE POINTS FOR SECTION A           :    20.4653
LOCATION AVERAGE POINTS FOR SECTION B           :    11.3172
LOCATION AVERAGE POINTS OF TOTAL POINTS         :    31.7091


                    BREAKDOWN OF LOCATION INFORMATION

 *** OWNERSHIP ***
    JOBBER OWNED AND OPERATED           :  2990                       59.2%
    JOBBER LEASED                       :  1428                       28.3%
    OWNED BY MAJOR OIL COMPANY          :    27                         .5%
    INDEPENDENTLY OWNED/OPERATED        :   598                       11.8%

 *** RECOMMENDATIONS ***
    1 = INVENTORY CONTROL METHODS       :  2734         29.3%         54.2%
    2 = MONITORING WELL                 :  2316         24.8%         45.9%
    3 = WEEKLY WATER CHECK              :  2275         24.3%         45.1%
    4 = INVENTORY RECORD RETENTION      :  1153         12.3%         22.8%
    5 = EMPTY-ABANDONED TANKS           :   400          4.3%          8.0%
    6 = MISCELLANEOUS                   :   442          4.7%          8.7%
                                   TOTAL   9328       % TOTAL   % LOCATIONS

 *** MONITORING WELLS ***
    NUMBER OF LOCATIONS WITH MONITORING WELLS INSTALLED  :  67


                     BREAKDOWN OF TANK INFORMATION

                                ---- AGE ----           ------ GALLONS ------
                                                           1    1001    6001
                COUNT          0-9  10-15  16+        -1000  -6000  -10000  10001+

STEEL-UNPATD :  18419  95.1%   5871  4542  8006 43.5%  4343   9367   3527   1182
STEEL-EPOXY  :    338            25    77   236           9    263     39     27
     (Liner) :                  200    56     2
STI-P3       :    274           252    10    12          13    106    120     35
FIBERGLASS   :    340           196   115    29           8    108    195     29
```

BEST COPY AVAILABLE

Office of the Illinois
State Fire Marshal
DIVISION OF FIRE PREVENTION

TO: JOANNE BAHURA
U.S.E.P.A.

FROM: DWIGHT R. ELLIOTT, DEPUTY STATE FIRE MARSHAL DRE.

SUBJECT: ESTIMATED NUMBER OF U/G LEAKS AND GALLONAGE
8/1/84 - 7/31/85

DATE: 12 AUGUST 85

Estimated number of underground leaks and gallonage

Underground leaks	Petroleum	Gallons
Marion	64	17,600
Springfield	46	11,400
Chicago	72	16,800
	182	45,800
Springfield	1 - Hazardous Materials	500

FORMULA:

Known leak responses X 3 = Total
Known tank replacement X ½ = Total
Known tank relining X ½ = Total

500 gallons per known leak
100 gallons per replacing tanks
100 gallons per relining tanks

3150 Executive Park Drive, Springfield, Illinois 62706 • 217/782-7381

```
                  *** UNDERGROUND TANK EVALUATION OF LOCATIONS ***
REPORT NMBR                  FEDERATED MUTUAL INSURANCE CO                   DATE
 10P310                                                                   ~~[illegible]~~
                          DATA ANALYZED FOR STATE:  IL                     7-31-85


                              GENERAL INFORMATION

NUMBER OF POLICYHOLDERS                              :      184
NUMBER OF LOCATIONS                                  :      408
NUMBER OF TANKS                                      :     1613
AVERAGE NUMBER OF LOCATIONS PER POLICYHOLDER:            2.2173
AVERAGE NUMBER OF TANKS PER LOCATION                 :          3.9534

LOCATION AVERAGE POINTS FOR SECTION A                :         20.9325
LOCATION AVERAGE POINTS FOR SECTION B                :          9.0771
LOCATION AVERAGE POINTS OF TOTAL POINTS              :         29.8674

 **** WARNING ****        NUMBER OF LOC  &  RECORD COUNT   SHOULD EQUAL, BUT DO NOT
                               408             415


                       BREAKDOWN OF LOCATION INFORMATION

 *** OWNERSHIP ***
    JOBBER OWNED AND OPERATED          :   300                         73.5%
    JOBBER LEASED                      :    69                         16.9%
    OWNED BY MAJOR OIL COMPANY         :     3                           .7%
    INDEPENDENTLY OWNED/OPERATED       :    43                         10.5%

 *** RECOMMENDATIONS ***
    1 = INVENTORY CONTROL METHODS      :   229          20.4%          56.1%
    2 = MONITORING WELL                :   216          26.7%          52.9%
    3 = WEEKLY WATER CHECK             :   238          29.5%          58.3%
    4 = INVENTORY RECORD RETENTION     :    76           9.4%          18.6%
    5 = EMPTY-ABANDONED TANKS          :    42           5.2%          10.2%
    6 = MISCELLANEOUS                  :     5            .6%           1.2%
                               TOTAL       806         % TOTAL    % LOCATIONS

 *** MONITORING WELLS ***
    NUMBER OF LOCATIONS WITH MONITORING WELLS INSTALLED  :  6


                          BREAKDOWN OF TANK INFORMATION

                                ---- AGE ----           ------ GALLONS ------
                                                           1    1001    6001
                COUNT          0-9  10-15  16+        -1000  -6000  -10000  10001+

STEEL-UNPRTD :  1458 90.4      442   315   701 48.1    426    761    227     44
STEEL-EPOXY  :    71             3    22    46           0     56      6      9
      (Liner):                  52    19     0
STI-P3       :    32            29     3     0           1      5     26      0
FIBERGLASS   :    52            30    19     3           0     18     32      2
```

ipma

Illinois Petroleum Marketers Association
P.O. BOX 1508 ■ 112 WEST COOK STREET, SPRINGFIELD, ILLINOIS 62705 ■ PHONE (AC 217) 544-4609

WILLIAM R. DEUTSCH
EXECUTIVE VICE PRESIDENT

PROPERTY AND CASUALTY LIABILITY
INSURANCE SURVEY

IPMA Member Response.....................Over 100 Responses

Attached is a sample of the findings. All express a need for some type of relief.

VERY IMPORTANT INSURANCE SURVEY

IPMA NEEDS UPDATED COMMENTS ON PROPERTY AND CASUALTY INSURANCE. MEMBERS OF CONGRESS AND THE SMALL BUSINESS ADMINISTRATION ARE INTERESTED IN YOUR ANSWERS TO THE QUESTIONS BELOW. IPMA BELIEVES THAT BY PROVIDING THEM WITH THE SURVEY FIGURES, MEMBERS OF CONGRESS WILL BE MOVED INTO HIGH GEAR TO PUSH FOR SOME TYPE OF RELIEF FROM PRESENT INSURANCE CRISIS. PLEASE ANSWER THE QUESTIONS BELOW AND RETURN TO THE IPMA OFFICE AS SOON AS POSSIBLE SO RESULTS CAN BE COMPILED AND PREPARED FOR PRESENTATION.

1. Who was your insurance company during the past year? Federated Insurance

2. Was your policy renewed X or cancelled ______ ? (Check One)

3. Was your premium increased? yes
   Give Comparisons: 1984 Total Premium 15,000
   1985 Total Premium 24,000
   1986 Total Premium 24,000

   Was coverage and deductible same as previous year? yes
   Give Comparisons: 1984 Total Coverage 1
   1985 Total Coverage ______
   1986 Total Coverage ______

4. How has an increase in premium impacted your business? (For example, have you had to stop expansion, decrease employees or increase prices?) Not trying to expand as hard can't afford the extra expense

5. If policy was cancelled, were you able to secure a new insurance carrier? -
   Name new insurance carrier ______

6. Does your policy include pollution liability? yes If so, what amount of coverage? (Be sure your policy does include Pollution liability for underground tank leaks.) ______

   Were you unable to get pollution liability? ______

7. Are you presently considering self-insurance? yes

8. Do you have an umbrella? yes If so, how much? 1,500,000
   Does it include pollution? (Be sure to check this) yes

9. Are you doing daily inventory control? yes

10. Have you had any claims in the past five years? (spills, collisions, leaking tanks, etc.) 1 Give Details: Fire in a plant building

11. Does your new policy contain a "claims-made" clause? (In claims-made policies, the insurance company is liable only for claims actually filed while the policy is in effect.) ______ What is the effective date? ______

    Does the "claims-made" include "Tail Coverage"? (The new claims-made policy now gives insureds the right to purchase supplemental "tail coverage" regardless of the reason for cancellation or nonrenewal. It guarantees insureds who purchase supplemental tail coverage, reinstatement of 100% of the aggregate limit of liability under the policy for all claims reported after the end of the policy period. In addition, it entitles insureds to receive loss information on claims and occurrences in sufficient specific detail to facilitate their decision to accept or reject an application for general liability insurance.) ______

12. The petroleum industry has felt the crunch in obtaining insurance coverage for truck fleets in compliance with federal and state law requirements. Many fleets have been able to get the first million dollars of coverage, but have been unable to obtain the umbrella up to the 5 million dollars required by law and terminals for those transporting gasoline and other petroleum products. What has been your experience? ______

13. Comments: A 5 million dollar is so expensive if I have to have one of them they can for get it I will sell and Do something els for a living

Optional Signature: ______
Company: ______
City, State: ______

RETURN TO: Illinois Petroleum Marketers Association
P.O. Box 12020
Springfield, IL 62791

VERY IMPORTANT INSURANCE SURVEY

IPMA NEEDS UPDATED COMMENTS ON PROPERTY AND CASUALTY INSURANCE. MEMBERS OF CONGRESS AND THE SMALL BUSINESS ADMINISTRATION ARE INTERESTED IN YOUR ANSWERS TO THE QUESTIONS BELOW. IPMA BELIEVES THAT BY PROVIDING THEM WITH THE SURVEY FIGURES, MEMBERS OF CONGRESS WILL BE MOVED INTO HIGH GEAR TO PUSH FOR SOME TYPE OF RELIEF FROM PRESENT INSURANCE CRISIS. PLEASE ANSWER THE QUESTIONS BELOW AND RETURN TO THE IPMA OFFICE AS SOON AS POSSIBLE SO RESULTS CAN BE COMPILED AND PREPARED FOR PRESENTATION.

1. Who was your insurance company during the past year? Home Insurance

2. Was your policy renewed ______ or cancelled X ? (Check One)

3. Was your premium increased? NO

Give Comparisons:
1984 Total Premium ______
1985 Total Premium ______
1986 Total Premium ______

Was coverage and deductible same as previous year? NO

Give Comparisons:
1984 Total Coverage ______
1985 Total Coverage ______
1986 Total Coverage ______

4. How has an increase in premium impacted your business? (For example, have you had to stop expansion, decrease employees or increase prices?) ______

5. If policy was cancelled, were you able to secure a new insurance carrier? YES
Name new insurance carrier Bituminous

6. Does your policy include pollution liability? NO If so, what amount of coverage? (Be sure your policy does include Pollution liability for underground tank leaks.) ______

Were you unable to get pollution liability? YES

7. Are you presently considering self-insurance? YES

8. Do you have an umbrella? YES If so, how much? 2,000,000. —
Does it include pollution? (Be sure to check this) NO

9. Are you doing daily inventory control? YES

10. Have you had any claims in the past five years? (spills, collisions, leaking tanks, etc.) NO Give Details: ______

11. Does your new policy contain a "claims-made" clause? (In claims-made policies, the insurance company is liable only for claims actually filed while the policy is in effect.) NO What is the effective date? ______

Does the "claims-made" include "Tail Coverage"? (The new claims-made policy now gives insureds the right to purchase supplemental "tail coverage" regardless of the reason for cancellation or nonrenewal. It guarantees insureds who purchase supplemental tail coverage, reinstatement of 100% of the aggregate limit of liability under the policy for all claims reported after the end of the policy period. In addition, it entitles insureds to receive loss information on claims and occurrences in sufficient specific detail to facilitate their decision to accept or reject an application for general liability insurance.) ______

12. The petroleum industry has felt the crunch in obtaining insurance coverage for truck fleets in compliance with federal and state law requirements. Many fleets have been able to get the first million dollars of coverage, but have been unable to obtain the umbrella up to the 5 million dollars required by law and terminals for those transporting gasoline and other petroleum products. What has been your experience? ______

13. Comments: LACK OF POLLUTION COVERAGE WILL PROBABLY FORCE US TO SELL OUR STATIONS.

Optional Signature: ______
Company: ______
City, State: ______

RETURN TO: Illinois Petroleum Marketers Association
P.O. Box 12020
Springfield, IL 62791

BEST [illegible]

VERY IMPORTANT INSURANCE SURVEY

IPMA NEEDS UPDATED COMMENTS ON PROPERTY AND CASUALTY INSURANCE. MEMBERS OF CONGRESS AND THE SMALL BUSINESS ADMINISTRATION ARE INTERESTED IN YOUR ANSWERS TO THE QUESTIONS BELOW. IPMA BELIEVES THAT BY PROVIDING THEM WITH THE SURVEY FIGURES, MEMBERS OF CONGRESS WILL BE MOVED INTO HIGH GEAR TO PUSH FOR SOME TYPE OF RELIEF FROM PRESENT INSURANCE CRISIS. PLEASE ANSWER THE QUESTIONS BELOW AND RETURN TO THE IPMA OFFICE AS SOON AS POSSIBLE SO RESULTS CAN BE COMPILED AND PREPARED FOR PRESENTATION.

1. Who was your insurance company during the past year? Federated

2. Was your policy renewed ✓ or cancelled ____ ? (Check One)

3. Was your premium increased? Yes

   Give Comparisons:
   1984 Total Premium 8,440-
   1985 Total Premium 12,490-
   1986 Total Premium 16,000-

   Was coverage and deductible same as previous year? Very Similar
   Give Comparisons:
   1984 Total Coverage ____
   1985 Total Coverage ____ All 3 yrs
   1986 Total Coverage ____

4. How has an increase in premium impacted your business? (For example, have you had to stop expansion, decrease employees or increase prices?) All Expansion on hold, wage concessions & benifit Reduced significantly!

5. If policy was cancelled, were you able to secure a new insurance carrier? ____
   Name new insurance carrier N/A

(6.) Does your policy include pollution liability? Yes If so, what amount of coverage? (Be sure your policy does include Pollution liability for underground tank leaks.) ____

   Were you unable to get pollution liability? ____

7. Are you presently considering self-insurance? No

(8.) Do you have an umbrella? Yes If so, how much? 2 million
   Does it include pollution? (Be sure to check this) ____

9. Are you doing daily inventory control? Yes

10. Have you had any claims in the past five years? (spills, collisions, leaking tanks, etc.) None Give Details: N/A

11. Does your new policy contain a "claims-made" clause? (In claims-made policies, the insurance company is liable only for claims actually filed while the policy is in effect.) ____ What is the effective date? Not the policy, but coming on renewal - at least that is what I've been reading
   Does the "claims-made" include "Tail Coverage"? (The new claims-made policy now gives insureds the right to purchase supplemental "tail coverage" regardless of the reason for cancellation or nonrenewal. It guarantees insureds who purchase supplemental tail coverage, reinstatement of 100% of the aggregate limit of liability under the policy for all claims reported after the end of the policy period. In addition, it entitles insureds to receive loss information on claims and occurrences in sufficient specific detail to facilitate their decision to accept or reject an application for general liability insurance.) N/A

12. The petroleum industry has felt the crunch in obtaining insurance coverage for truck fleets in compliance with federal and state law requirements. Many fleets have been able to get the first million dollars of coverage, but have been unable to obtain the umbrella up to the 5 million dollars required by law and terminals for those transporting gasoline and other petroleum products. What has been your experience? do not own Transport vehicle

13. Comments: Being a small petro. jobber, the dollar impact has been very hard hitting! Margins have not allowed us to pass the cost on, ability for to survive, operating cut backs have been instituted!

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1. Who was your insurance company during the past year? TRAVELERS

2. Was your policy renewed X or cancelled ______ ? (Check One)

3. Was your premium increased? YES
   Give Comparisons: 1984 Total Premium 2,419.00
   1985 Total Premium 3,932.00
   1986 Total Premium ______

   Was coverage and deductible same as previous year? NO
   Give Comparisons: 1984 Total Coverage 1,500.00
   1985 Total Coverage 1,000.00
   1986 Total Coverage ______

4. How has an increase in premium impacted your business? (For example, have you had to stop expansion, decrease employees or increase prices?) PROFIT LESS, COST'S UP

5. If policy was cancelled, were you able to secure a new insurance carrier? ______
   Name new insurance carrier ______

6. Does your policy include pollution liability? NO If so, what amount of coverage? (Be sure your policy does include Pollution liability for underground tank leaks.) ______

   Were you unable to get pollution liability? YES

7. Are you presently considering self-insurance? YES

8. Do you have an umbrella? NO If so, how much? ______
   Does it include pollution? (Be sure to check this) ______

9. Are you doing daily inventory control? NO

10. Have you had any claims in the past five years? (spills, collisions, leaking tanks, etc.) NO Give Details: ______

11. Does your new policy contain a "claims-made" clause? (In claims-made policies, the insurance company is liable only for claims actually filed while the policy is in effect.) NO What is the effective date? ______

    Does the "claims-made" include "Tail Coverage"? (The new claims-made policy now gives insureds the right to purchase supplemental "tail coverage" regardless of the reason for cancellation or nonrenewal. It guarantees insureds who purchase supplemental tail coverage, reinstatement of 100% of the aggregate limit of liability under the policy for all claims reported after the end of the policy period. In addition, it entitles insureds to receive loss information on claims and occurrences in sufficient specific detail to facilitate their decision to accept or reject an application for general liability insurance.) ______

12. The petroleum industry has felt the crunch in obtaining insurance coverage for truck fleets in compliance with federal and state law requirements. Many fleets have been able to get the first million dollars of coverage, but have been unable to obtain the umbrella up to the 5 million dollars required by law and terminals for those transporting gasoline and other petroleum products. What has been your experience? NO UMBRELLA AVAIL.

13. Comments: I CANNOT MAKE A LIVING FROM THIS BUSINESS ONLY. I HAVE ANOTHER BUSINESS TO FALL BACK ON. I AM TRYING TO SELL OUT BUT NO ONE HAS MONEY TO BUY.

VERY IMPORTANT INSURANCE SURVEY

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1. Who was your insurance company during the past year? USF&G

2. Was your policy renewed ______ or cancelled ✓ ? (Check One)

3. Was your premium increased? YES

Give Comparisons:
1984 Total Premium 35,492
1985 Total Premium 46,136
1986 Total Premium 55,363

Was coverage and deductible same as previous year? YES, EXCEPT DOT TANKS COVERAGE WAS INCREASE BUY $1,000 each yr.

Give Comparisons:
1984 Total Coverage ______
1985 Total Coverage ______
1986 Total Coverage ______

4. How has an increase in premium impacted your business? (For example, have you had to stop expansion, decrease employees or increase prices?) NO, BUT IT'S MORE DIFFICULT TO JUSTIFY EXPANSION

5. If policy was cancelled, were you able to secure a new insurance carrier? YES
Name new insurance carrier AMERICAN STATES

6. Does your policy include pollution liability? NO If so, what amount of coverage? (Be sure your policy does include Pollution liability for underground tank leaks.) ______

Were you unable to get pollution liability? YES

7. Are you presently considering self-insurance? NO

8. Do you have an umbrella? YES If so, how much? 2,000,000
Does it include pollution? (Be sure to check this) NO

9. Are you doing daily inventory control? YES

10. Have you had any claims in the past five years? (spills, collisions, leaking tanks, etc.) NO Give Details: ______

11. Does your new policy contain a "claims-made" clause? (In claims-made policies, the insurance company is liable only for claims actually filed while the policy is in effect.) N What is the effective date? ______

Does the "claims-made" include "Tail Coverage"? (The new claims-made policy now gives insureds the right to purchase supplemental "tail coverage" regardless of the reason for cancellation or nonrenewal. It guarantees insureds who purchase supplemental tail coverage, reinstatement of 100% of the aggregate limit of liability under the policy for all claims reported after the end of the policy period. In addition, it entitles insureds to receive loss information on claims and occurrences in sufficient specific detail to facilitate their decision to accept or reject an application for general liability insurance.) ______

12. The petroleum industry has felt the crunch in obtaining insurance coverage for truck fleets in compliance with federal and state law requirements. Many fleets have been able to get the first million dollars of coverage, but have been unable to obtain the umbrella up to the 5 million dollars required by law and terminals for those transporting gasoline and other petroleum products. What has been your experience? I have no trucks

13. Comments: this thing is getting completely out of hand — there is no reason for almost doubling cost in two yrs time - I'm reluctant to submit a claim for fear of cancellation or another big increase in premium

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1. Who was your insurance company during the past year? USF&G

2. Was your policy renewed yes or cancelled ______ ? (Check One)

3. Was your premium increased? yes
   Give Comparisons: 1994 Total Premium ______
   1985 Total Premium 37,461
   1986 Total Premium 58,497

   Was coverage and deductible same as previous year? yes, except pollution liability Cancelled + No 5 million Umbrella
   Give Comparisons: 1984 Total Coverage ______
   1985 Total Coverage ______
   1986 Total Coverage [illegible]

4. How has an increase in premium impacted your business? (For example, have you had to stop expansion, decrease employees or increase prices?) ______
   We are policeing our company more carefully.

5. If policy was cancelled, were you able to secure a new insurance carrier? ______
   Name new insurance carrier ______

6. Does your policy include pollution liability? No If so, what amount of coverage? (Be sure your policy does include Pollution liability for underground tank leaks.) ______

   Were you unable to get pollution liability? yes

7. Are you presently considering self-insurance? No

8. Do you have an umbrella? No If so, how much? ______
   Does it include pollution? (Be sure to check this) ______

9. Are you doing daily inventory control? yes

10. Have you had any claims in the past five years? (spills, collisions, leaking tanks, etc.) No Give Details: ______

11. Does your new policy contain a "claims-made" clause? (In claims-made policies, the insurance company is liable only for claims actually filed while the policy is in effect.) No What is the effective date? ______

    Does the "claims-made" include "Tail Coverage"? (The new claims-made policy now gives insureds the right to purchase supplemental "tail coverage" regardless of the reason for cancellation or nonrenewal. It guarantees insureds who purchase supplemental tail coverage, reinstatement of 100% of the aggregate limit of liability under the policy for all claims reported after the end of the policy period. In addition, it entitles insureds to receive loss information on claims and occurrences in sufficient specific detail to facilitate their decision to accept or reject an application for general liability insurance.) ______

12. The petroleum industry has felt the crunch in obtaining insurance coverage for truck fleets in compliance with federal and state law requirements. Many fleets have been able to get the first million dollars of coverage, but have been unable to obtain the umbrella up to the 5 million dollars required by law and terminals for those transporting gasoline and other petroleum products. What has been your experience? Can't get umbrella

13. Comments: For years we have had 5 million umbrella + 1 million in regular policy. We are now unable to get the umbrella, we have never had a claim on our Umbrella

VERY IMPORTANT INSURANCE SURVEY

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1. Who was your insurance company during the past year? INA

2. Was your policy renewed Yes or cancelled ______ ? (Check One)

3. Was your premium increased? ______
   Give Comparisons: 1984 Total Premium 10,000
   1985 Total Premium 13,000
   1986 Total Premium ______ due upon Audit [illegible] for 35,0

   Was coverage and deductible same as previous year? Same
   Give Comparisons: 1984 Total Coverage ______
   1985 Total Coverage ______
   1986 Total Coverage ______

4. How has an increase in premium impacted your business? (For example, have you had to stop expansion, decrease employees or increase prices?) We have Stopped Much Adv. Increased Prices

5. If policy was cancelled, were you able to secure a new insurance carrier? ______
   Name new insurance carrier ______

6. Does your policy include pollution liability? No If so, what amount of coverage? (Be sure your policy does include Pollution liability for underground tank leaks.) ______

   Were you unable to get pollution liability? Yes Couldn't Afford It

7. Are you presently considering self-insurance? ?

8. Do you have an umbrella? Yes If so, how much? 1.5 Million
   Does it include pollution? (Be sure to check this) No

9. Are you doing daily inventory control? No Weekly

10. Have you had any claims in the past five years? (spills, collisions, leaking tanks, etc.) Yes Give Details: 4 year ago leased truck to another Jobber + 250,000 suit on behalf [illegible] had an wreck with [illegible]

11. Does your new policy contain a "claims-made" clause? (In claims-made policies, the insurance company is liable only for claims actually filed while the policy is in effect.) Yes What is the effective date? ______

    Does the "claims-made" include "Tail Coverage"? (The new claims-made policy now gives insureds the right to purchase supplemental "tail coverage" regardless of the reason for cancellation or nonrenewal. It guarantees insureds who purchase supplemental tail coverage, reinstatement of 100% of the aggregate limit of liability under the policy for all claims reported after the end of the policy period. In addition, it entitles insureds to receive loss information on claims and occurrences in sufficient specific detail to facilitate their decision to accept or reject an application for general liability insurance.) ?

12. The petroleum industry has felt the crunch in obtaining insurance coverage for truck fleets in compliance with federal and state law requirements. Many fleets have been able to get the first million dollars of coverage, but have been unable to obtain the umbrella up to the 5 million dollars required by law and terminals for those transporting gasoline and other petroleum products. What has been your experience? N/A

13. Comments: In 1985 We Broke even If Insurance goes up 10 to 20 Thousand we will have to take a good serious look at staying in business / We are [illegible] related in the tune of 90% and that speaks for itself.

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1. Who was your insurance company during the past year? The Hartford

2. Was your policy re ______ or cancelled ______ ? (Check One) Due in April, '86

3. Was your premium in ? Yes

   Give Comparisons: 1 Total Premium 67,600

   19 tal Premium 104,000

   1986 tal Premium [illegible] more increase

   Was coverage and deductible same as previous year? Yes

   Give Comparisons: 1984 Total Coverage Same

   1985 Total Coverage Same

   1986 Total Coverage Same

4. How has an increase in premium impacted your business? (For example, have you had to stop expansion, decrease employees or increase prices?) [illegible]

5. If policy was cancelled, were you able to secure a new insurance carrier? N/A

   Name new insurance carrier ______

6. Does your policy include pollution liability? No If so, what amount of coverage? (Be sure your policy does include Pollution liability for underground tank leaks.) ______

   Were you unable to get pollution liability? Yes

7. Are you presently considering self-insurance? No

8. Do you have an umbrella? Yes If so, how much? 4 Million

   Does it include pollution? (Be sure to check this) No

9. Are you doing daily inventory control? Yes

10. Have you had any claims in the past five years? (spills, collisions, leaking tanks, etc.) No Give Details: ______

11. Does your new policy contain a "claims-made" clause? (In claims-made policies, the insurance company is liable only for claims actually filed while the policy is in effect.) No What is the effective date? ______

    (Note the "claims made" include "Tail Coverage": (The new claims-made policy now gives insureds the right to purchase supplemental "tail coverage" regardless of the reason for cancellation or nonrenewal. It guarantees insureds who purchase supplemental tail coverage, reinstatement of 100% of the aggregate limit of liability under the policy for all claims reported after the end of the policy period. In addition, it entitles insureds to receive loss information on claims and occurrences in sufficient specific detail to facilitate their decision to accept or reject an application for general liability insurance.) ______

12. The petroleum industry has felt the crunch in obtaining insurance coverage for truck fleets in compliance with federal and state law requirements. Many fleets have been able to get the first million dollars of coverage, but have been unable to obtain the umbrella up to the 5 million dollars required by law and terminals for those transporting gasoline and other petroleum products. What has been your experience? Had trouble in 85 and were cancelled in 86.

13. Comments: [illegible]

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1. Who was your insurance company during the past year? Reliance

2. Was your policy renewed ______ or cancelled X ? (Check One)

3. Was your premium increased? Yes

Give Comparisons:
1984 Total Premium 12,000.
1985 Total Premium 38,000
1986 Total Premium Don't know yet but have been told will be up Considerably

Was coverage and deductible same as previous year? NO

Give Comparisons:
1984 Total Coverage 6,000,000
1985 Total Coverage 3,000,000
1986 Total Coverage Supposed to be 3,000,000

4. How has an increase in premium impacted your business? (For example, have you had to stop expansion, decrease employees or increase prices?) Slowed expansion and if gets too high may have to go out of business.

5. If policy was cancelled, were you able to secure a new insurance carrier? ______
Name new insurance carrier Was Cancelled at expiration - Trying to get a new insurer

6. Does your policy include pollution liability? I did If so, what amount of coverage? (Be sure your policy does include Pollution liability for underground tank leaks.) 1,000,000 with 2,000,000 umbrella but don't know about new policy

Were you unable to get pollution liability? Don't know for sure.

7. Are you presently considering self-insurance? Maybe partially - but is dangerous

8. Do you have an umbrella? Yes If so, how much? 2,000,000
Does it include pollution? (Be sure to check this) Yes it did

9. Are you doing daily inventory control? Yes

10. Have you had any claims in the past five years? (spills, collisions, leaking tanks, etc.) No Give Details: ______

11. Does your new policy contain a "claims-made" clause? (In claims-made policies, the insurance company is liable only for claims actually filed while the policy is in effect.) The new one will [illegible] What is the effective date? 3/1/86 if we can get one.

Does the "claims-made" include "Tail Coverage"? (The new claims-made policy now gives insureds the right to purchase supplemental "tail coverage" regardless of the reason for cancellation or nonrenewal. It guarantees insureds who purchase supplemental tail coverage, reinstatement of 100% of the aggregate limit of liability under the policy for all claims reported after the end of the policy period. In addition, it entitles insureds to receive loss information on claims and occurrences in sufficient specific detail to facilitate their decision to accept or reject an application for general liability insurance.) ?

12. The petroleum industry has felt the crunch in obtaining insurance coverage for truck fleets in compliance with federal and state law requirements. Many fleets have been able to get the first million dollars of coverage, but have been unable to obtain the umbrella up to the 5 million dollars required by law and terminals for those transporting gasoline and other petroleum products. What has been your experience? Same problem. Can't get the required amount

13. Comments: We are in a [illegible] of a mess and must just pray that we are not wiped out by an unexpected [illegible].

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The National Association of Full-Service Plumbing, Heating, Cooling and Piping Products Wholesalers

American Supply Association
20 N. Wacker Dr.
Chicago, Illinois 60606
312/236-4[illegible]2

Peter W. Schwartz
Executive Vice President

STATEMENT BY

WILLIAM M. QUINN

AMERICAN SUPPLY ASSOCIATION

BEFORE THE

SENATE SMALL BUSINESS COMMITTEE

HEARINGS ON SMALL BUSINESS

AND LIABILITY INSURANCE

FEBRUARY 20, 1986

[illegible]ABLE

Mr. Chairman: My name is William M. Quinn of Memphis, Tennessee. I am President of General Pipe and Supply Company and Chairman of the Government Affairs Council of the American Supply Association. ASA is the national trade organization for the plumbing-heating-cooling-piping industry, most of which are small, family-run businesses.

As a plumbing-heating-cooling-piping wholesaler and officer in my national association, I have had considerable discussion with business associates and fellow wholesalers on the alarming increases in insurance premiums and reductions in insurance coverage that have occurred nationwide. We can provide a vast body of anecdotal information on businesses that have experienced huge increases in liability insurance premiums, that have been denied coverage or face termination of their policies, that have been forced to self-insure and thereby jeopardize assets that have been accumulated over several family generations, or that will simply go-out-of-business rather than face continued risk or depletion of their businesses. We are confident that the committee will receive these kind of examples from the witnesses called before you today, not only from my own state of Tennessee but from throughout the nation. Stories of the calamity in insurance protection abound and plainly illustrate the crisis facing small businesses today.

For its part, ASA has attempted to gather data from throughout its membership and quantify those results in a manageable form. Our results come from over two hundred wholesale businesses located throughout the 50 states. The response from our members confirms what we have heard individually and duplicates the experience of many other hard-pressed industries. The results can be summarized as follows: a large majority of ASA members indicated that they were experiencing substantial increases in premiums in

Commercial auto and truck insurance	86.3%
Property and casualty insurance	78.8%
Product liability insurance	76.9%

Further, for officers and directors liability insurance (which only applied to 40% of the responding companies, due to the nature and size of our businesses), 61.5% of our respondents experienced increases. The median increase in premiums for all types of coverage was 50%.

In recent years, we have taken a particularly close look at product liability coverage, a problem which is illustrative of trends throughout the insurance industry. As wholesalers, we are product sellers rather than manufacturers. In most instances, we function as a distributor, in the truest sense of the word. We have little to do with the product beyond transportation, storage and sale. Only under unusual circumstances do we become involved in any transformation or assemblage of a product during the period that it is in our control. Yet we are being sued, and less frequently held financially accountable, for harm that has resulted from the use of that product. This we attribute to our legal system, which employs a Robin Hood mentality to compensating victims. The logical progression and application of product liability to our industry was recently noted by John McDonald of the Brock-McVey Company of Louisville, ASA's former President and Chairman of the Board. McDonald notes insurance industry statistics that most accidents occur in close proximity of the home. Of these, the vast majority of injuries occur in the bathroom, where, in turn, a vast majority occur in the shower or tub. In this illustration, McDonald is being somewhat facetious, but only to a point and his conclusion has an increasingly ominous ring to our members. In a no-fault legal environment where plaintiffs and juries look to the availability of funds for a judgment -- the so-called "deep pocket" -- plumbing-heating-cooling-piping wholesalers can expect increased exposure and a continuing upward spiral to premiums. Manufacturers, wholesalers and contractors know that, irrespective of provision for safety devices, a danger that has been known to man for centuries -- getting in and out of the tub -- can become the legal cause of action that drives our members out of business in the 1980s.

In our survey, plumbing-heating-cooling-piping wholesalers first point to the symptons -- higher premiums -- but time after time mention the root cause of the problem to be the legal system. It is this problem that we seek to address: reform of the tort system. We well understand that there are elements of this task that appropriately should be assumed at the state-level. However, this is a national problem that spans states' boundaries and permeates all of interstate commerce. It is a national small business issue, a commerce issue, a judicial issue and an economic issue.

We urge your committee to move past the symptons of this crisis -- which we join other national organizations in reaffirming as exactly that, a crisis -- and take a comprehensive look at how Congress can appropriately reform the tort system. We will have specific recommendations as you move ahead with your deliberations and look forward to working with you towards a solution.

Our survey results follow and, with the permission of the Committee, are incorporated in our testimony.

LIABILITY INSURANCE SURVEY

1. Has your company experienced substantial premium increases with your liability insurance coverage?

   a. commercial auto and truck liability:

   yes 86.3% no 13.7%

   % increase 50%

   b. officers and directors liability:

   yes 25.5% no 13.6% does not apply 60.7%

   % increase 50%

   c. property and casualty:

   yes 78.8% no 20.1%

   % increase 50%

   d. pollution liability:

   yes 1.1% no 6.8% does not apply 92.1%

   % increase ____

   e. product liability:

   yes 76.9% no 23.1%

   % increase 50%

   f. other: ____________________

2. Do you consider product liability to be a problem for your company?

   yes 55.7% no 44.3%

   If yes, how serious is the problem?

   extremely 27.8% very 28.7% somewhat 43.3%

   Why? ____________________

3. What are your present liability insurance limits? $ 2,000,000 (median)

Additional comments: ____________________

Please Return To:

American Supply Association
Government Affairs Office
1919 Pennsylvania Avenue, Suite 300
Washington, D.C. 20006

2. Do you consider product liability to be a problem for your company? Why?

    - Claims on the increase
    - Court judgments must be capped - attorney's fees must not be contingent on judgement
    - We have very little control/we should have more.
    - Being a division of a Fortune 500 Company, we are considered having deep pockets. Many suppliers do not have adequate coverage.
    - We have been named in suits for things we have no control over.
    - It's passed on to manufacturers - but our insurance cancels.
    - Potential financial liability.
    - High premiums; thin to non-existent product markets; unpredictable legal environment.
    - We get sued along with the contractor who installed job and the manufacturer. This is happening everytime a modest amount of damage is done by a poor installation in the field. Attorneys are having a field day!
    - As a packager of valves and activators, we are caught "in-between" the two principal manufacturers. Due to rising costs, we were forced to reduce coverage by ½ this 1986; i.e., from $3 million to $1.5 million
    - Never sure of some potential uncovered liability
    - We are named in lawsuits caused by our vendor's goods.
    - We sell products that can be dangerous if misused or mishandled.
    - We do not install but in a lawsuit we would probably be sued.
    - Even though products are delivered in manufacturers cartons, any legal action includes distributor and therefore we must defend ourselves.
    - Underwriting is disregarded and company raised premium just to raise the premium.

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- Never know what the court will allow.
- Unfounded lawsuits.
- Lawyers
- Do not believe we should have to take it. We only serve as distributors.
- Defense costs.
- Too high, for a wholesaler is only the middleman.
- Ability to tender a manufacturer for defense.
- Possibly could find ourselves not being able to insure for the catastrophe and have our business lost through a suit.
- Litigation and documentation consume vast amounts of time - heavy research task.
- All these lawsuits and very costly settlements and legal fees.
- We are caught in the middle and our executive exposure keeps premiums high.
- Present philosophy in courts/Import Products
- With the size of the current awards - one suit which previously was minor could bankrupt us.
- We are small and a large award could wipe us out.
- The problem is simply the cost. We do not feel we have very much exposure but cannot afford to be without it.
- When a suit is filed, all are included, liable or not.
- Because we have not experienced any serious product liability claims.
- Public awareness increases risk. Problem not extreme because we represent quality manufacturers.

Additional Comments:

- We secured substantial premium savings in 1985 by getting bids on our coverage. However, we do expect substantial premium increases in 1986, even though we have filed no claims in 1985.
- Product liability suits have become the legal "out" for the "careless - inept - ignorant and greedy" product abuser.
- Could be one of ASA's greatest accomplishments if it could be instrumental in contributing to some control over this very serious insurance problem.
- Our extended use of printed disclaimers, on our invoices on warranties and liability, have greatly reduced our insurance problems. (At least according to our Insurance Company).
- Vehicular insurance is almost unaffordable to a small company with 15 or so units.
- Insurance costs are becoming too expensive to be practical.
- Taking competitive bids has kept our insurance costs pretty much under control.
- Totally agree that governmental action is a must as these costs make U.S. companies totally uncompetitive and seriously jeopardize profitability and corporate existance.
- All American manufacturers have product liability policies which relieves our responsibilities.
- All insurance costs going up! This time of year when policy becomes due is a bad time to have a survey - increase yet unknown and what to do about that anyway - insurance is practically uncontrollable! Switching carriers is about impossible especially at this time of carriers refusing to cover/quote, etc.
- We have noted substantial redefinition of limits and exclusions. Premium pay schedule has been accelerated.
- We expect some problems in cost and coverage with insurance. Presently we do not have a problem because we are on a 3-year package policy and it is not up for renewal until Spring 1987. This product liability issue is getting way out of hand. Something must be done.... We had one case in 1985 and it was settled out of court for a small amount (should be nothing) but the legal fees and all the lawyers involved were terrible.

- Being wholesale and distributor, it comes up rarely - hard to show negligence on our part.
- 1986 coverages will be adjusted to economic considerations including self-insurance.
- We have one suit (truck accident) pending now asking $16 million that we feel a few years ago would have been settled for under $25,000. This case will bankrupt one branch if not settled under $3 million.
- Rates should be controlled by legislation.
- Additional insurance was too expensive, plus our insurance is scheduled to go up again in 1986 by 40%.
- Congress needs to set a limit on the amount of awards by juries. Awards of millions of dollars are very unreasonable.
- We had to reduce our umbrella limits because of cost increases.
- It is imperative that we have legislation to base ceilings on claims and related costs - legal, medical - to bring down the 100% loss incurred by the insurance industry.
- There is no logic that we responsible for products which we do not change or alter.
- No product liability insurance on imported products.
- Anything that can be done to bring the costs back in line with reality will be appreciated. This situation may not get worse next year but, I have been told, it won't get any better.
- After paying premiums, you have to have your attorney argue with the insurance company's attorney to make them acknowledge the incident is in fact covered, and they have exposure. After settlement of damages (in our case) they shared, rather than paid, the damages. Additionally, you find yourself in an adversarial position with your manufacturer's insurance attorneys.
- I feel there are two problems, first there are too many lawyers and contingency fees should not be allowed.
- We are concerned about the "claims made form" recently adopted in Ohio on general liability insurance. Also the inclusion of legal fees as a part of the policy's claim limit.

- In the last 2 years, our insurance claims have increased 100%. We have gone from approximately $20,000 premiums in 1984 to $40,000 premiums for the upcoming 1986 year. It is getting ridiculous.
- Auto liability up largely due to new and additional vehicles - casualty and product liability up primarily due to the present tight market and not due to loss experience.
- Increase % based on most recent insurance renewal only. Liability increase is despite no loss experienced by insurance company.
- Will probably have difficulty purchasing adequate excess coverage this year. Will definitely pay increasingly exorbitant premiums.
- Our increase is far less than the industry, because of careful shopping for insurance and the expert guidance of an independent insurance counselor. I am well aware of others who have seen increases over 100%.
- Our insurance cost in 1986 will decrease significantly because we have taken the business from our local agent and given it to the captive agency for our hardware supplier (True Value).
- We have an umbrella coverage for any additional liability beyond our coverage limit.
- Premium for total "package" business owner's policy increased 62.1%. In other words, product and property/casualty liability were included in total increase, and therefore didn't increase any more than fire, external coverage, burglary, etc.

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CONSULTANT

February 20, 1986

The Honorable Lowell P. Weicker, Jr.
Chairman
Committee on Small Business
428A Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Weicker:

I am writing and submitting comments on behalf of the Coalition of Automotive Associations (CAA), to be included as part of the record of the hearings held by this Committee on February 20 and 21, concerning the cost and availability of liability insurance. CAA is a trade association comprised of over 2,100 small businesses which manufacture and distribute aftermarket parts and accessories for motor vehicles.

It is an undisputable fact that there is a current problem in the marketplace in finding affordable liability insurance - if such insurance still exists. The problem has quickly evolved into a crisis which is affecting numerous industries and professions. Unfortunately, small businesses seem to have been hit the hardest. Over the past two years, many of our members have found that product liability insurance, at any price, was wholly unavailable to them and they have been forced to continue in business without the insurance protection which is essential to provide for the reasonable recovery of legitimate consumer claims. Still more of our members have found that the levels of insurance available to them have decreased from $10 million, to $5 million, to $1 million, and now, $300,000 in aggregate claims. Even though insurance is available to them, the levels are such as to render the insurance essentially meaningless. For those who are offered coverage in amounts approaching $300,000, the premiums have increased to $25,000 to $50,000 per year where they had been previously averaging $2,000 to $5,000 per year for $5 million in product liability coverage. The remaining few of our members who have been successful in retaining reasonable limits of liability coverage have experienced increases in premiums of 300 to 1,000 percent.

It appears that there are several factors which have contributed to the current situation, such as the descent from high interest rates of recent years, the withdrawal of national re-insurance groups outside of the United States, and the general litigious character of American society. While it is not precisely clear how to remedy the situation, it is obvious that something has to be done. The impact on the business community has been devastating. Companies have been driven out of business, prices of consumer products have sharply increased and injured consumers with legitimate claims are frequently finding that those who might be liable have no capability of compensating them for their losses due to their limited assets and lack of insurance coverage.

A part of the solution for dealing with this exploding crisis is to provide a tort liability system which has more predictability and certainty than what currently exists. Historically, obtaining liability insurance was a relatively simple task since liability claims could be accurately projected based on past experience, which provided a predictable basis upon which to establish premiums. This was capable of being done because it was known that the standard for liability would be based on negligence. Although negligence was defined by state law, and there obviously were some differences among the various state laws, the rules for defining what would constitute negligence and the consequences of that negligence were reasonably ascertainable in a given state. Within the last couple of decades, however, there have been creative new theories under which compensation has been awarded to injured plaintiffs. Courts today appear to be placing more emphasis on the relative ability of plaintiff and defendant to absorb the consequences of defendant's activity than on the defendant's culpability. This is apparent with the increased use of the doctrine of strict liability. This evolution of the tort system was accompanied by a dramatic increase in litigation, including large awards for punitive damages and for non-economic losses. CAA strongly supports the action taken by the members of the Senate Committee on Commerce, Science and Transportation in the area of product liability reform. Their proposed uniform federal product liability law will hopefully restore the predictability and certainty of tort liability to allow small business to once again obtain affordable and adequate insurance coverage.

We applaud this Committee for addressing the problem of the cost and availability of liability insurance and request that the members take action to effectively remedy the situation. We further request that the members of this Committee support the action taken by your colleagues in the Senate Committee on Commerce, Science and Transportation with regard to product liability reform.

We appreciate having the opportunity to comment and look forward to Committee action addressing the serious problem which has arisen in the insurance market and detrimentally effected the entire business community.

Sincerely,

John Russell Deane III

JOHN RUSSELL DEANE III

JRD/sdg

ORBIT

ORBIT VALVE COMPANY

A DIVISION OF ORBIT VALVE INTERNATIONAL, INC.

February 12, 1986

The Honorable Dale Bumpers
United States Senate
Washington, D. C. 20002

Dear Dale:

Product Liability is in the crisis stage in the United States and, thankfully, the NAM is organizing a visit to Capitol Hill so that we have the opportunity of visiting with you about the extent of our problems. I haven't brought this subject up before because I felt like a voice in the wilderness yelling about such a complex problem so I'm thankful it is finally coming to a head.

Here is what has happened to Orbit Valve Company:

- In February 1985, our Excess Liability insurance was cancelled in mid-term with no reason given. When your policy is cancelled in mid-term it is impossible to obtain coverage. Our coverage was reinstated only after the State Insurance Commissioner intervened on our behalf.

- Our primary policy expired on September 30th, 1985, and we spent untold hours and money working with our insurance agents to finally put together a liability package, but not until after our previous one had expired.

  The premium on the new package is six times what we were paying, and we only have one-third as much coverage. We also have a much higher deductible and more exclusions than we had with our previous policy. It is now costing us over $600,000 a year for this reduced coverage.

- Because of the nature of the business we are in, we face the constant threat of our policy being cancelled, possibly for no reason other than they have decided not to insure people selling to the oil and gas industry any more. If our policy is cancelled, we will probably not be able to obtain coverage at all.

- We are involved in about six lawsuits a year -- most all of which I would consider totally frivilous. We have not been found guilty of any error in 10 years.

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The typical scenario is this: An accident occurs, a lawyer records the name of every piece of equipment within a 50 to 200 ft. radius of the accident and everyone who has equipment in that area is sued.

- Even though we only have half a dozen suits a year, they are so complicated and time consuming that we are close to the point of having to hire a full-time engineer/attorney just to keep up with it.

Dale, all of this has to be built into the cost of our product and our foreign competitors do not have these costs. They sell through distributors in the U.S. and so have little or no assets in the U.S. other than a sales office, so if there is a lawsuit against them, there is nothing to be collected. We're having a tough enough time with foreign competition without having to bear this additional burden.

The most frightening scenario I can see, though, is the very real possibility that we will be unable to obtain liability insurance. If this happened (and it is happening to many privately owned companies) then I have a decision to make -- should I risk the assets of my entire family on a freak accident and a freak judgement or should I sell out and let somebody else take the risk?

If you are the owner of a small or medium size company with only one product the risk is staggering. You can be completely wiped out with one judgement. In a conglomerate, one subsidiary could be destroyed; however, the parent company could survive. This is not true in a "one product" company.

I am the third generation to run this company and my son hopes to follow behind me. I don't like the thought of being forced out by the threat of an uninsured product liability suit, but it would be the prudent thing to do.

Dale, you have read some of the horror stories -- the awards are insane! Manufacturers in the United States face enough competition without also having this cost and threat on our backs. It is not only making us less competitive but we are going to see a lot of private companies sell out to conglomerates or just close their doors rather than operate without liability coverage. That's going to be a sad day for America, because it's the small businessman who creates the jobs in this country - not the large corporations.

Most of the blame is placed on the lawyers and insurance companies but I believe the fault lies in our judicial system that allows these unreasonable judgements. The federal government must do something about this problem and do it fast!

I hope you will set aside an hour for me on the afternoon of March 11th, 1986, to discuss what I consider to be the biggest problem facing U. S. manufacturers today.

I'll be in contact with you later as far as what would be a convenient time.

Sincerely,

Ed D. Ligon, Jr.
President

/am

Michael A. Hatch
Commissioner

February 25, 1986

The Honorable Dale Bumpers
U.S. Senate
229 Dirksen Office Building
Washington, D.C. 20510

Dear Senator Bumpers:

I am the primary regulator of the insurance industry for the State of Minnesota. I think the proposals for tort reform currently being debated by Congress misses the point. I frankly think that "tort reform" is an attempt by the insurance industry to finger point the blame for its own mismanagement on the judicial system.

If we want to address the problems in the insurance industry, I strongly urge that a federally chartered insurance corporation be set up, along the same lines of the FDIC, to monitor this industry.

Indeed, if you think that the property/casualty crisis is difficult, I can assure you that the same crisis will come home, in spades, with the life insurance industry in approximately three to five years and it is not too late to address that crisis.

I enclose a copy of a very brief memo to Governor Perpich regarding various proposals in the legislature that are similar to the bills you are currently reviewing.

If you are interested, I would be more than willing to testify as to the fallacy of the various tort proposals being thrusted upon Congress by the insurance industry.

Very truly yours,

Michael A. Hatch

MAH:ss
Encl.

STATE OF MINNESOTA
DEPARTMENT OF COMMERCE
500 Metro Square Building, St. Paul, Minnesota 55101

STATE OF MINNESOTA
Office Memorandum

DEPARTMENT Commerce

TO: Governor Perpich

DATE: 2/10/86

FROM: Michael A. Hatch
Commissioner

PHONE: 6-6848

SUBJECT: Insurance Unavailability Crisis

I. Issues

- Insurers have abandoned, to a large degree, specialty lines of commercial liability insurance (products, liability, day care centers, professional liability, municipalities, over-the-road truckers, etc.)
- The current anti-competitive situation in many specialty lines is resulting in exhorbitant rates.
- Insurance in many specialty lines is not available at all or is available for such a short duration that businesses are "going bare."

II. Background

In February, 1985, the Insurance Services Office (ISO) predicted that the demand for property/casualty insurance would exceed available supply by $62 billion over the next three years, with over 90% of this capacity shortfall occurring in commercial lines. The basis upon which this projection was made is that the industry's capacity to sell insurance is restricted by its net worth. A common guideline for the industry is that a carrier should not accept premiums of more than 300% of its net worth during any one year. This is commonly called the "surplus to premium" ratio. Since the industry has a limited net worth, the ISO office projected that the capacity of the industry was to accept approximately one-quarter of a trillion dollars of insurance during the year 1985. They noted that there was a far higher demand for insurance than that capacity level.

BEST [illegible] LE

The cause of the demand for insurance to outstrip the supply of insurance is several:

1) Deregulation of the insurance industry and the value of money.

During the early '80s, many insurers simply insured anyone or any business that showed up at their door. The idea was to get the money in the door and get a 30% return on the investment dollar, which many companies projected during the early '80s. Since insurance carriers hold on to the dollar for many years, that 30% compounding factor has a dramatic effect on the value of insurance. In fact, the insurers have experienced poor returns on their investment (interest rates dropped substantially) and the gap between the investment income and the expected investment income far exceeded the claims that came in.

This phenomenon also occurred in savings and loans and banks, with the same crisis being present, but not hitting the consumer as much due to FDIC and FSLIC insurance.

2) There has been an increase of the demand for property and casualty insurance.

At least $1.6 billion of the insurance industry capacity has been used to insure securities and bonds. ISO estimates the capacity gap between supply and demand to be approximately $7 billion. Accordingly, the $1.6 billion allocation to securities is a tremendous use of insurance capacity. Such insurance was not even sold in a measurable basis 10 years ago. Other examples of increased demand include business interruption insurance, satellite insurance, computer insurance, software insurance, substantially increased use of directors and officers liability insurance, etc. Most of these coverages were very rare 10 years ago.

3) There has been a growth in the frequency and severity of claims as it relates to the premium income.

The combined ratio for the industry in 1984 was 117%, which means that for every dollar taken in, about $1.17 will be paid when the last claim is paid and the last paper clip is bought. When one includes investment income at 15%, the ratio is cut to 102%. When one includes tax credits, the industry actually had a positive return on assets. Nevertheless, the industry had a bad year in 1984.

Similarly, the year 1985 was worse, principally due to an unpredecedented number of catastrophes and airline crashes, and commercial (non-personal injury) lawsuits.

III. Effect on the Market Place

The end result of the gap between supply and demand is that many insurance companies are withdrawing from the specialty lines of commercial insurance and devoting almost all of their attention to personal lines, such as auto and homeowners insurance, and the more broad commercial classifications such as general liability insurance for retail stores. Insurers can easily underwrite these broad risks without any appreciable difference in overhead.

Such allocation of a carrier's capacity to the more populated areas of insurance is not uncommon in an industry that deregulates. The same situation has occurred in airlines, trucking, railroad, banking, telephones and communications. For instance, it is cheaper to fly from Los Angeles to New York ($99.00) than it was 10 years ago. On the other hand, you cannot fly from Fairmont to Minneapolis any more.

Similarly, in those lines where competition is present, the premium increase has been approximately 10% to 15%. This follows the philosophy of deregulation, namely that competition is the most efficient regulator of rates.

In some specialty lines of insurance, however, there is such a small demand by the market place that only one or two carriers can possibly sell the insurance. In these areas, no competition is present. For in stance, in all of the lines that are affected (liquor liability, taxis, products liability, municipals, bank surety bonds, directors and officers liability insurance, common carriers insurance, legal medical and accountants malpractice insurance, day care insurance, etc.) there are less than 5,000 policyholders in the state. Even when this demand is spread throughout the country, there is still too small a pool to attract any insurance carriers. Thus, in these lines you see a 300% to 1000% increase in rates.

The policyholder suffers as a result of this lack of competition and underwriting of the early '80s.

IV. Conclusions as to Market Conditions

I believe the triple-digit increase in the specialty lines are principally due to the lack of market competition.

The insurance industry defenders, however, argue that if there is such excessive profit-taking occurring in the specialty lines, then other insurance carriers would surely jump into the market and bring competition. While this might be the case in other commercial areas, this is not possible in insurance. This is because an insurance carrier must have several thousand policyholders in order to "spread the risk." This is the basic concept behind insurance. Obviously, if there are only 5,000 or 10,000 insurance policyholders in a given class of business, and there are only two carriers currently selling the insurance in the class of business, it is not as beneficial to a third carrier to jump into the market. First of all, they would likely end up getting the poorer risks in the market place. Secondly, if there are only 5,000 policyholders, they know they must dislodge at least one of the other carriers in order to win. Finally, the insurance executive must ask himself why he would want to spend all the additional overhead for actuaries, underwriters, claims adjusters, etc., to get familiar with a specialty class of business when he can use the capacity of his insurance company to sell in the safe lines. (Remember, the demand is on his side.)

V. Tort Reform

There is growing pressure on the business community to restrict the amount of recovery available to persons injured through the activities or products of a business or profession. The claim is that such reforms to Minnesota tort laws will reduce the amount that a claim can finally recover thereby reducing the amount the insurance companies must pay out. Accordingly, premium rates should be reduced.

While I believe it is necessary that the Administration support some changes in "tort law," I believe that the argument presented by the insurance industry is an attempt to fingerpoint their own mismanagement on the judicial system.

The insurance industry insists that the rapid escalasting increase in specialty insurance is necessary in order to pay for claims. Accordingly, they state that the triple digit increases which have occurred in the specialty lines of insurance noted above are due to increased claims. It should be emphasized, however, that the specialty lines of insurance occupy under 20% of the entire property and casualty insurance market. If increased claims were the cause of triple digit increases in the specialty lines of insurance, I would think that such increased claims would *also* occur in the other 80% of the insurance market, namely automobile and homeowners insurance, where most of the claims are made. In those areas of insurance, however, the increased premium has been approximately 10% to 15%, which as I noted earlier is reflective of market conditions.

Also, if the insurance industry were being candid in stating that these triple digit increases were due to increased claims, then one would assume that their profits would fall off as well.

Yet, when one looks at *Forbes* and *Fortune* magazines, they specifically note that insurance stock is one of the hottest stocks to buy. Indeed, the stocks of various insurance companies are selling at record highs and are projected to go even higher. Further, in August the *Journal of Commerce* reported that the insurance industry reported a *350% increase* in profits over the last year. Many of our regional companies such as St. Paul Insurance reported a record fourth quarter. They would have had a record year but for the fact that they had a lot of insurance on property destroyed by the hurricanes that hit the Gulf States last year. Such losses could hardly be attributed to the "tort" system.

Nevertheless, I do believe it is important that changes occur in the tort system and that those changes benefit the consumers of insurance.

VI. *Administration Position*

A. Even though the crisis is nationwide in character, and must be addressed as such, the State has the responsibility to the business community to make sure that insurance is available and is not excessive. Accordingly, the proposals state:

(1) *Excessive Rates*: In those classes of insurance where less than five insurance carriers occupy 75% of the market, the Department should have the authority to take action if it believes that excessive rates are being charged. In the event that

the Court determines that excessive rates are being charged, the Department may order a refund of the excessive rates to the policyholder (similar to the public utilities regulatory process).

(2) Joint Underwriting Association: In those areas of business where the State mandates insurance or where insurance is essential to the States "health," a joint underwriting association will guarantee availability of insurance.

(3) Filing Bill: Insurance carriers must file specific information substantiating the basis for rates charged by class of insurance. The industry must be able to defend its rates and regulators must have appropriate data.

B. The State should also take action with regard to change of liability laws affecting claims.

(1) Caps on Awards: I have told the Minnesota Medical Association and a Governor's task force on municipalities that we do support the capping of non-economic damage at $250,000.

(2) Statutes of Limitation: Similarly, we support the shortening of Statutes of Limitation.

(3) Collateral Source Rule: We support the elimination of the collateral source rule as it pertains to health insurance, disability insurance, etc. I have indicated that we have some reservation with regard to the elimination of the collateral source rule as it pertains to social security.

(4) Structured Settlements: The administration does support the use of "periodic payment of damage awards" as stated in the Minnesota Medical Association Report.

(5) Elimination of punitive damages: In 1984, I issued a policy statement indicating that insurance carriers may exclude punitive damages from insurance coverage. Indeed, it has been a policy of the Minnesota Courts to exclude punitive damages from insurance coverage.

(6) Application of the above claims to general business: Currently there is no bill which applies the above liability law changes across the board. I have discussed with legislators the Administration's support of consistent, across the board changes. All such changes must apply to the whole business community.

C. Long-Term Issues: Let's Not Let This Occur Again!

All of the above changes address symptoms of the insurance crisis, but do not address the crisis itself. This crisis seems to raise its ugly head approximately every six or seven years, which is roughly the length of the insurance cycle. Each time the cycle hits a trough, the crisis gets that much deeper. I believe that a fundamental change must occur in insurance regulation. There must be a set of uniform standards throughout the country to assure that insurance carriers are operating in a sound manner. Currently, there is no federal regulation of insurance companies. I do believe some federal approach must be made, namely that there be a Federal Deposit Insurance Corporation-type of apparatus which is federally chartered and has the authority to audit and examine insurance companies to assure that they are operating in a safe and sound manner. Currently we must trust that insurance carriers which are doing business in Minnesota, domiciled in other states, which make up 90% of the insurers, are being adequately examined by those states. We know that is fiction and we must face the reality and address these problems on a broader basis.

Specifically, the Administration may wish to support:

(1) Federally-Chartered Insurance Corporation for Insurance Carriers:

Congress should authorize the chartering of a Federal Insurance Corporation for insurance carriers. The purpose of the corporation would be to replace the individual state's guaranty funds and other inconsistent approaches to resolving insurance solvency matters. I have asked Jim DeChaine, Director of the Minnesota - Washington

Office, to arrange for me to testify, if possible, at the Congressional hearings currently being held regarding insurance.

(2) Frequency of Claims

None of the above proposals, and none of the bills presented, deal with the fundamental problem on the claims side of insurance, namely the frequency of claims that are made. All of the above legislative changes affect "severity" of claims, namely the high injury type of claims which get a lot of publicity but do not affect the insurance system nearly as much as the frequency of small claims. I am specifically referring to the "slip and fall" claims at restaurants which cause $4,000 in damage due to a broken ankle, and end up with $4,000 in lawyer's fees being incurred by the insurance carrier and the victim to resolve the damage. Another example would be claims that are made against a horse stable for liability when, in fact, the visitor to the horse stable should have "assumed the risk" of any injury.

To resolve this situation, I believe the Governor should appoint a commission to address the issue of small claims frequency. Resolutions in this area will have a substantial effect on the tort liability system. The commission should report the issues it discussed and make specific recommendations to the Legislature in December.

The commission should be comprised as follows:

1) at least three prominent judges, one at the appellate level and another at the trial level;

2) two insurance carrier CEOs;

3) two defense lawyers;

4) two plaintiff's lawyers;

5) two representatives of the business community;

6) one consumer advocate (probably from Common Cause);

7) the Commissioner of Commerce, and

8) the Attorney General.

M.A.H.

MAH:nl

STATEMENT OF THE AMERICAN CAMPING ASSOCIATION ON THE LIABILITY INSURANCE CRISIS AND ITS EFFECT ON THE ORGANIZED CAMPING INDUSTRY

BY
ARMAND B. BALL
EXECUTIVE VICE-PRESIDENT
AMERICAN CAMPING ASSOCIATION
MARTINSVILLE, INDIANA

AND

ALAN STOLZ
CAMP CODY
WEST OSSIPEE, NEW HAMPSHIRE

FEBRUARY 20, 1986

BEFORE THE SENATE COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C.

concern shared by camp owners and operators. The survey revealed that one quarter (24%) of New Hampshire camps are considering closing their doors because of markedly increased premiums or unavailable coverage. One third (32%) have dropped key programs (horseback riding, boating, repelling, ropes, gymnastics, etc.) because of premium increases. An additional one sixth (16%) dropped key programs due to inability to find coverage. Not one camp which responded to the survey has had a serious loss, claim, or settlement to justify premium increases.

The insurance trend, as it relates to camping, is actually a continuum of sharp premium increases experienced in the seventies. As is the case currently, those increases were incurred without relation to loss experiences. Ten years ago the National Board of the ACA appointed an ad hoc insurance committee to examine the problems in the field, and suggest alternatives. After a year or so of study, the Committee recommended that a captive insurance company be formed. Initial approval was received, and a managing agency was retained to help with formation. Start up funds were secured as were commitments from the necessary number of camp directors, but the plan was aborted when efforts to secure reinsurance at reasonable rates proved unsuccessful.

At the time, the major problem in securing reinsurance was the lack of any history of losses in the camp field. The Committee went back to the drawing board and entertained bids for group insurance with the hopes of developing a strong program with heavy participation, which would as a consequence provide a history of losses.

That program commenced in 1982 with the Rhulen Agency of Monticello, N.Y. Since that time, our insurance committee has been meeting annually with agency principals to study losses, with the objective of developing a loss history to make forming a captive a more viable future alternative. Unfortunately, the state of the current reinsurance market is undermining our efforts.

Consequently, the Committee was recently charged with the duty of investigating self-funded or self-insurance programs as an alternative to rapidly increasing premiums.

In the interim, insurance rates have climbed from 50% to 600% in camps with no loss histories. Insurance on a single horse has risen as high as $1,500.00 for a summer season. Camps have been forced to sign child abuse waivers, sometimes retroactively under threat of immediate policy cancellation.

What can be done to help alleviate the problem? We view the crisis -- and we have had a decade to look at it -- as

Mr. Chairman, the American Camping Association, on whose behalf we are submitting testimony today, represents a vast segment of the organized camping interests in the United States. Since its inception in 1910, the Association, a nationwide, nonprofit, nonsectarian organization, has been committed to the continuing values and benefits unique to the organized camp setting. The ACA recognizes that through group living in the out-of-doors, both children and adults find special kinds of experiences that help them to develop physically, mentally, emotionally, and spiritually.

Over four million youngsters participate in summer camp yearly. They find diverse challenging activities in day camps and resident camps of many kinds -- privately owned, social agency or religiously affiliated, institutional, and special purpose camps, covering and protecting more than a million acres of prime recreational land across the United States. The ACA works with many groups and professional organizations to assure camping's accessability to individuals of all ages, including the elderly, the economically disadvantaged, the learning disabled, and those with physical impairments, among others.

Unfortunately, all this is threatened by the development of social and economic dependence upon insurance. The inability to secure insurance -- either due to unavailability or unaffordability -- has obvious implications.

The insurance difficulties of organized camps transcend the distinct differences of the multitude of different types of camps and camping. It makes no difference if you are the small family owned operation, or the big city agency program, the effect is the same -- erosion of important programs offerings, increases in participation fees, and most importantly a diminishment of the longstanding ability of organized camping to provide millions of children and adults the opportunity to participate in our unique programs.

Needless to say, the organized camps in this country have fallen victim to the current insurance trend. With the reams of testimony before the Committee, it may be to a large degree repetitive, to get into the horror stories which we most definitely share with other small business sectors.
It may, however, be instructive to take a brief look at the current statistical trend. Our most current data is three weeks old and is derived from a survey conducted by Mr. Stolz across the State of New Hampshire. We believe that this most recent data is indicative of the national trend, so we have decided to present this somewhat of a micro-economic look at the national situation.

It is interesting to note that this voluntary survey by mail, sent to every camp in the State -- of which there are 165 -- drew a response rate in excess of 50% in less than 72 hours. The speed of the response is to us an indicator of the degree of essentially tripartite. Tort abuse, insurance industry mismanagement or misdirection, and the under utilization of comprehensive risk management all have contributed significantly to the problem.

The order in which we have listed these joint causes is in no way indicative of their relative importance. In fact, if you look at the problem from the stand point of problem avoidance, versus problem resolution, the last cause, namely under utilization of comprehensive risk management, is of paramount importance. If we can better design a system to encourage accident avoidance, everyone except the plaintiff's attorney will win. In a climate where the insurance industry is sensitive to risk avoidance, you would think that risk management would be embraced with open arms. Yet getting experienced company risk managers to take a more active role is more often than not like pulling teeth. The American Camping Association has taken the initiative and has developed a comprehensive and effective safety standards program for use by our affiliated camps. We strongly recommend that the Committee take a long hard look at how the insurance industry and the private sector in general handle risk management. Stronger incentives -- other than fear of premium increases, which appear in any event to have little relation to loss history -- are needed across the board. The old adage that an ounce of prevention is worth a pound of cure could not hold truer than here.

Tort reform is perhaps the most popular of proposed solutions to the insurance crisis, at least from the standpoint of the unprecedented expansion of civil litigation in this country. It is our experience that the expansion of litigation is largely regional. For the sake of continuity, getting back to New Hampshire, the number of cases filed in that state actually dropped by 691 from 1980 to 1984. At the same time the State population rose by 10%, and the cost of living rose by about 30%. New Hampshire does not recognize punitive damages, and in its entire history has only had two verdicts in excess of $450,000. Yet liability insurance premiums, during that same period, rose 43% statewide. In short, New Hampshire, and indubitably many other States, are paying for the litigation arising under the laws of other jurisdictions.

Obviously the insurance crisis is not limited to regional sectors of the country. We are all sharing in the burden. This fact has led us to the conclusion that some degree of uniformity -- and a tightening of the reins if you will -- is in order with respect to our tort system. Eleven States have in their wisdom abandoned exemplary damages. Why then is a national movement to control excessive verdicts by limiting these damages met with cries of foul, and declarations that this concept is totally foreign to our deep rooted system of civil justice?

Similar arguments can be advanced with respect to caps on pain and suffering, the inequity of joint and several liability, the double cost of the collateral source rule, the erosion of the doctrine of assumption of risk, and caps on lawyers' contingency fees. It is very important to note that these issues pose problems not only with respect to product liability, but with service industries, such as ours, and virtually every other entity, both profit and non-profit, engaged in commerce. A balance must be struck between the deterrent effect of our civil justice system, and the detrimental effect of generating an over reliance on litigation. We strongly encourage the Committee to take whatever steps necessary, whether through the use of incentives to the states or Federal preemptive powers, to restore some semblance of balance to the system of civil justice we all value.

Likewise, we believe Congress should explore potential avenues of Federal oversight with respect to wayward insurance industry practices. The power of Federal purse strings, when it comes to providing incentives for state regulatory enforcement, is available and should be used if necessary.

From the insurance industry standpoint, the most apparent contributor to the current crisis was an over dependence on investment income, and an under reliance on prudent underwriting practices. We question the desirability of permitting a reoccurrence of this practice if our goal is stability.

There remain a number of other industry practices worthy of review. Most agree that the claims history of individual establishments should play a more direct role in premium calculation. An analogy can be drawn between the unemployment compensation program, where individual business employment histories are tracked for purposes of premium calculation -- and industry size, function, location, and other group factors are recognized as being largely irrelevant. Public policy should lend rewards -- greater than that of simply not being sued -- to establishments that implement safety programs with successful results.

A separate but related issue involves current rating systems which have a distorting effect upon true risk estimation. This is particularly so in the camping field, where insurer rating systems fail to recognize organized camps as independent risks. Camps are on the whole a heavily supervised, safety conscious industry, with a superlative loss ratio. Most camps, including those with American Camping Association accreditation, have comprehensive safety programs which form an integral part of their operation. Yet insurer standards assign ratings based upon a host of separate risk codes, too often totally independent of the camp situation. It is not uncommon for a small camp to be rated with major liveries if it has a horse, with restaurants if it has a kitchen, with timber companies to the extent it is located in the woods, and with marinas if it has a canoe. This to us is a prime example where insurance industry convenience has given way to unrepresentative actuarial practice, at the cost of unnecessarily high premiums.

SUMMARY AND CONCLUSION

Organized camping is an important adjunct to our society. Every year private independent and non-profit camps serve over four million youths, from all social and economic backgrounds, and contribute over $4 billion to the national economy. These contributions are at great risk by virtue of abuses of the civil tort system, insurance industry mismanagement, and inadequate risk management programs.

Congress should use incentive legislation, or if necessary Federal preemptive powers, to make measured changes in tort liability standards and rules which address the entire system of commerce. Attention should not be limited to product liability, but should be extended to service industries, and all others similarly affected.

Congress should act on legislation to correct insurance mismanagement and ensure that those who create hazards share a greater burden of the cost. Likewise, there should be protection for organizations with no significant loss history.

Lastly, the Congress should pay greater attention to problem avoidance and prevention, and consider substantial incentives for improved risk management programs.

Statement by the

NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS

concerning the

COMMERCIAL LIABILITY INSURANCE CRISIS

submitted to the

COMMITTEE ON SMALL BUSINESS
U.S. SENATE

February 12, 1986

Mr. Chairman and Members of the Committee on Small Business, this statement is submitted on the insurance availability crisis by the National Association of Professional Insurance Agents (PIA).

PIA has more than 40,000 members. They are independent insurance agents and brokers located throughout the 50 states, Puerto Rico, the Virgin Islands and Guam. PIA members service all lines of insurance but have special expertise in the property/casualty side of the business. As independent business owners, they represent several insurance companies, have access to a greater number of insuring markets through brokerage agreements, and oversee an average of five employees.

As independent agents, we have a legally recognized right to the renewals of the business we produce. This right belongs to the agent. Our clients are always free to choose their company and agent at any point. The worth of our agency as a business is based primarily upon the assessed value of our renewal book of business. Therefore, while we may be a licensed agent for this company or that, our allegiance to our client is very strong. Company-agent relations may come and go, but we take great care to continually build and service our clientele.

This unique characteristic of the American Agency System gives independent agents and brokers a unique perspective. We listen to and understand the concerns and needs of our clients and share these real-world conditions with our companies so that sensible responses can be made. Conversely, it is our responsibility to take complex and highly technical insurance matters and make them clear and understandable to our customers. This responsibility has been placed to the supreme test during the current market conditions.

The Types of Markets:

Insurance companies and their rating organizations can provide the Committee in great detail how the insurance market arrived at this point. However, we believe an abbreviated version from our viewpoint might be helpful in placing this into perspective. To do so, we will define capacity, describe the three basic insurance markets and how they interrelate.

Capacity:

Capacity is the ability (in dollars) of the insurance industry to insure the dollar levels of liability the marketplace requests. The more dollars available in the industry, the more liability coverage it can handle. Capacity exists at every level. Each insurer and each of the following market segments has its own capacity. The aggregate of these comprises the total industry's capacity.

Primary Market:

This is the first layer market that provides the majority of insurance for most commercial coverage needs. Businesses seek to find coverage in this market first. It consists mostly of U.S. domestic companies that are licensed and admitted to do business in one or more states. With some exceptions, the kinds of risks insured, the coverages offered, and the limits of liability secured are generally of a standard nature.

Excess/Surplus Lines (E&S) Market:

This is the first level of the specialty market. Clients that need more coverage than the primary market will offer, or which require specialized coverages for the unique nature of the risk being insured, seek a first level of coverage here. The E&S market may also work in combination with a primary market policy to provide what we call a "layering" of coverage. This market is composed mainly of U.S. companies, but has a healthy mix of foreign companies who do business in this country. Companies are licensed to do business in their state of domicile, but generally they are allowed to operate in other states on what is known as a "non-admitted" basis. This allows greater freedom in the rates charged, and the wording of the specific coverages being offered. The E&S market provides innovation, creativity and elasticity that the industry needs to cover the insurance requirements of new and unique businesses as well as providing higher limits of liability so necessary in today's litigious society.

Reinsurance:

This market can act as a primary insurer for those lines of business or specific accounts that cannot be accommodated in either the primary or E&S markets. However, the major purpose of this market is to insure insurance. Most of the customers of this market are insurance companies. Reinsurance provides primary insurers with additional capacity to underwrite risks. Most times in negotiating with the reinsurer, the originating insurance company decides how much exposure from a book of business it will absorb and the balance is covered by the reinsurer. Some clients may choose to self insure the exposures and limits of liability

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that would normally be absorbed by the primary insurance market, and reinsure the balance. Most reinsurers are foreign but the number of domestic companies has been growing.

While there are variations on these themes, these are the main components. The health of each market segment affects the other. If the primary market constricts, more business will be forced into the E&S market, and possibly the reinsurance market. This may mean higher prices and changes in coverage but desired limits of liability may still be available.

When capacity shrinks at the reinsurance level, the pressure is felt down the line. Fewer clients can be accommodated or requested limits of liability cannot be fully secured. Premiums will increase. Lines of insurance considered marginal, because of inadequate actuarial data, or because rapidly evolving court decisions have made accurately pricing the risk impossible, may not be written at all. The current market has both elements.

How We Got Here:

In the late 1970s, a number of new reinsurance companies were formed, and an influx of capital came into the reinsurance marketplace. This provided almost instant capacity. The primary market was recovering from a capacity shortage it faced in the early to mid 1970s. The greater the capacity, the more coverage you can write, both in liability limits and the kinds of risks. Competition was keen. Interest rates were high, creating an incentive for insurance companies to generate cash flow for investment purposes.

These economic factors were being felt at the primary insurance level as well. Commercial risk insurers wanted to generate premium dollars up front so that they too could take advantage of the high yield interest rates. Some commercial clients moved towards self insurance adding an additional element of competition for insurers. In direct response to the demands of commercial clients and to counter a loss of market share, insurers kept offering lower prices and more coverage. Some even ventured into new lines of insurance, most notably in the pollution liability area. Once in motion, the cycle fed on itself, fueled by the economics of the time. Soon, interest earnings leveled off and the cash flow investment gravy train was over.

Another important side of this dilemma is the loss picture. The loss experience finally surpassed the industry's ability to attract capital and make up shortfalls between the price charged and the loss incurred with investment income. They had to return to underwriting on a profitable basis by charging sufficient premiums to cover the risk.

In addition to rate inadequacy, there were undeniable trends developing in the litigation area.

Pollution Exposures:

The most notable and far-reaching involved pollution exposures. We are only beginning to understand the nature of various pollution situations and the resulting liability exposure. This exposure is generated from three areas ... pollution exposures knowingly insured but whose potential loss was underestimated; risks now found to have a pollution exposure which were unknown at the time insured; and pollution exposures the industry thought it had excluded but have been held covered by the courts.

Liquor liability:

Another area where notable change took place was liquor law liability. A number of court cases were involved affecting saloon keepers, bartenders, companies serving alcohol at employee functions, and even private citizens hosting parties. The courts held these persons to varying degrees of liability for the bodily injury and/or property damage subsequently caused by those who had imbibed too much. This has substantially increased the nature of the risk for liquor law liability insurance.

Sovereign Immunity:

The erosion of sovereign immunity continues at all levels of government. The federal government recognizes this situation and has formed a special task force headed by the Justice Department to address the issue of tort law and the federal government's exposure. Municipalities and states have also been hit hard.

Product and Professional Liability:

Product liability and medical malpractice problems, which first hit the headlines in the 1970s, never went away. Again, these lines are in the news because of tight insurance markets and rising costs. Product liability tort reform is still not a reality, and doctors continue to be held to higher degrees of liability.

The nature of these and other previously insured risks are now unknown because they are changing so rapidly that past loss experience can no longer apply and/or because courts continually add new elements to it. Under these conditions, the insurance industry is at a loss to deal with them. Add to that, a lack of overall capacity and the ability to respond is either greatly reduced or eliminated.

The end result is that we have basically two market problems. First, there is the pressure caused by a lack of capacity. Time and capital infusion will arrest this dislocation. Second, market pressures exist that result from an inability of this industry to properly apply its trade (actuarial principles) to ascertain the nature and cost of certain exposures. For these risks, capacity recovery alone will not help. There must be at least two additional changes. One is tort reform to set reasonable boundaries to recovery. And second, there must be some appropriate government enforcement of existing regulatory and legislative oversight of these activities to eliminate the undesirable players.

What Can/Is Being Done:

A return to the sound underwriting principles will nurture recovery and maintain a stable market. PIA firmly believes that these tools can provide a fair and stable market for most commercial clients. Bargain basement premiums are hard to resist, but they lead to significant adjustments in the availability and affordability of insurance every few years. The business community would do well to opt for steady, gradual price increases instead.

The client's right to a stable market can also be improved by placing controls on midterm cancellations of policies and/or midterm premium increases. In October 1985, PIA adopted policy positions regarding these issues. We believe that midterm premium increases are wholly unjustified unless there has been some change in the risk. After being in effect for 60 days, a policy should not be cancelled midterm unless there is a material change to the risk that would render it uninsurable unless facts come to light that were unknown when the risk was written that would have materially affected the initial underwriting decisions. Nonpayment of premiums would be a legitimate reason for midterm cancellation. We recognize the problem an insurer can encounter when its reinsurance has been cancelled. Should that be the reason for the midterm cancellation. it should be discussed with the state insurance regulator, and an orderly plan of action developed. We are discussing this latter suggestion with our carriers to come to a mutually agreeable solution.

The time given for a notice of cancellation and nonrenewal is important too. PIA's positions suggest no less than a 30-day notice. We recognize that there may be cases where an insurer may wish to expedite these notices. Such exception should be discussed with the state insurance commissioner.

When and how a renewal quote is delivered affects the client's rights and the duty of agents and brokers to shop the market. We have recommended how this should be accomplished, and that the quotation should specify any change in the insuring agreement.

Ideally, these standards would be met voluntarily. However, most of the insurance industry concedes that some degree of mandation is necessary. To this end, PIA is working with the National Association of Insurance Commissioners (NAIC), individual companies, insurance trade associations,and state legislators. The level of cooperation from all parties is good. Resolution may be achieved by the end of the states' 1986 legislative session.

PIA, along with other members of the industry, are creating Market Assistance Programs (MAPS). There are three levels to MAP's:

- Market Analysis, which can uncover trends and problems,
- Information Hot Lines, which can be used by agents or consumers to inquire about whether coverage for their account can be placed and where, and
- Formalized MAP structures for identifying markets, and the placement of business within them.

How the MAP concept works is simple. Some degree of market dislocation occurs because an agent may have lost his particular market. This agent may be unaware of an agent or broker who may have an open market for the business. Once this market is identified, the agent can arrange a brokerage agreement with the insurance producer or company that does have the market. This does not add any cost to the insured. It does mean a probable lessening of commission earning for the originating agent. But some commission is better than none,

To assist PIA's state/regional affiliates in designing programs along these lines, PIA has just concluded our Annual National State Legislative Conference. The issue of, and solutions for, insurance availability/affordability were the main focus.

Tough markets challenge and bring to the forefront the creativity of agents and brokers in structuring insurance arrangements that meet the needs of their clients. In addition to piecing various levels of insurance together, agents and brokers are exploring self-insurance and captive insurance companies with their clients. These methods are not for all clients but alternative insuring mechanisms are here to stay. PIA believes that traditional insurance is the best approach. However, when that can't be achieved, we assist our clients in either structuring their own program, or placing them in an existing group. This demands a great deal of expertise on the part of the agent and broker, but learning new areas is a basic requirement of our job. PIA is sponsoring a seminar on captives for our members to learn how they operate.

The Long-Term Solutions:

Not all market problems will disappear with the introduction of more capacity. Reform of the problems that exist in the civil justice system must take place. This is where Congress can show leadership and effect change. PIA, as are many others, is involved in a number of efforts. We have joined with our clients' trade groups in seeking a fair and equitable resolution.

PIA supports the review and possible decrease of the limits in mandated financial responsibility (FR) laws. FR limits are not a cap on liability, nor do tortfeasors avoid having their business or personal assets placed at risk if the injury/damage is great enough. In some instances, government views FR limits as a device to make the insurance industry a quasi regulator. This is an inappropriate role for the private sector, and one this industry doesn't want. It places an artificial pressure on insurance capacity. There are only so many dollars to go around, and if

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insureds are forced by government to purchase higher and higher limits, then there will be fewer and fewer customers the insurance industry can accommodate.

This is apparent in the Motor Carrier Act of 1980. PIA heard of market problems as early as April 1984, from agents/brokers who specialize in the field. This was reported in the May 1984 issue of our magazine, PROFESSIONAL AGENT. Additionally, we brought this to the attention of Congress in our several hearing appearances. Congress should review all federal laws which impose FR limits.

Another long-term solution involves changes in insurance policy contracts. This is the cleanest and quickest way for the industry to alleviate problems in risks with long-tail exposure and/or sensitivity to changing legal interpretations.

Much has been written about the introduction of the new Commercial General Liability (CGL) policy, both the occurrence, and the new claims-made forms. PIA believes the recent changes the Insurance Services Office (ISO), an industry rating organization, has made in developing the CGL program will help reduce current market dislocations. This program will be perfected as market experience develops. Without this program, market problems will be exacerbated.

PIA worked closely with ISO in suggesting improvements to the program. The NAIC has done extensive work in furthering those improvements. It is our hope that insurance regulators will now find the package of policy changes acceptable.

Insurance Oversight:

PIA has a long-standing commitment to the state regulation of insurance. We believe it serves the consumer best in that it can respond to problems more quickly and precisely than can the federal government. It has served the public very well. The NAIC is developing the technology and talent to keep improving the standard of state regulations.

Company Solvency/Reinsurance:

The current system of insurance company insolvency protection has served insurance consumers well. However, the industry recognizes updating is needed. A number of proposals for change have surfaced in the last two years. PIA is preparing a major position paper on these issues. It will be discussed at the PIA National Board of Directors Meeting, February 25, 1986. We will be happy to share this document with you at that time.

Conclusion:

The cause of this market cycle is not singular. Short-term solutions will not be effective. The long-term resolutions require a commitment to act, and the involvement of all affected parties.

PIA believes that the focus Congress is placing on this issue is healthy. It heightens the sense of commitment to resolve these problems by those who wish to preserve the McCarran-Ferguson Act. Also, Congress can more clearly identify what role it should/could play.

Congress can best serve as a leader in exploring long-term tort solutions.

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NATIONAL SOCIETY OF PROFESSIONAL ENGINEERS
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AMERICAN
ACADEMY
OF ENVIRONMENTAL ENGINEERS

TESTIMONY
OF
LOUIS L. GUY, JR., P.E.
GUY AND DAVIS, CONSULTING ENGINEERS
ON BEHALF OF THE
NATIONAL SOCIETY OF PROFESSIONAL ENGINEERS
AND
AMERICAN ACADEMY OF ENVIRONMENTAL ENGINEERS
ON
INSURANCE PROBLEMS AFFECTING SMALL BUSINESSES
TO THE
U.S. SENATE
COMMITTEE ON SMALL BUSINESS

FEBRUARY 20, 1986

1420 KING STREET ■ ALEXANDRIA, VIRGINIA 22314 ■ 703-684-2800

132 HOLIDAY COURT, SUITE 206, ANNAPOLIS, MD 21401 ● 301/266-3311

It is my pleasure to respond to your Subcommittee's invitation regarding the insurance problems affecting small businesses

My name is Louis L. Guy, Jr., P.E., a partner in the firm of Guy & Davis, Consulting Engineers with offices in Richmond and Fairfax County, Virginia. I am testifying as President-elect of the American Academy of Environmental Engineers and National Director for the National Society of Professional Engineers.

AAEE is the organization that provides Board certification of environmental engineers. Organized in 1955, it's roster currently list over 2,300 certified environmental engineering specialists.

NSPE is a professional society, representing more than 75,000 engineers of all disciplines nationwide. Our members are organized into 54 state and territorial societies and 535 local chapters, and work in industry, education, private practice, construction and government.

Most engineering firms are small businesses. The average size firm employs less than 20 persons. The Small Business Administration (SBA) classifies any engineering firm with gross revenues of less than $7.5 million as a small business, although SBA is considering a lower threshold of $1.5 million. Currently, more than 95% of all architecture and engineering firms qualify as "small business" out of approximately 30,000 firms.

Engineering firms typically carry two basic types of insurance: (1) ordinary casualty and (2) professional liability coverage. In recent years the number of insurers providing professional liability policies for engineering/architectural firms has dwindled from more than a dozen to only two at present.

Our insurance crisis came upon us almost overnight. Several insurers are withdrawing from the market or refusing new customers. Meanwhile, our premiums have doubled and tripled over the past several years while deductibles are higher and coverage is lower.

Many engineering firms are caught in a dilemma because our insurance policies are being renewed this year with new language that excludes coverage for damages related to asbestos or to "pollution". In other words, we are definitely unable to obtain professional liability insurance coverage for hazardous waste cleanups, for industrial waste treatment, or for asbestos removal from buildings, to protect us against charges of negligence in the courts. There remain serious questions about coverage for municipal sewage treatment plants and water treatment plants. From now on, engineering firms will provide these services at their own risk, exposing both their business and personal assets from a damage suit.

As licensed professionals, the corporation form of business does not shield our personal assets from a damage suit. Moreover, insurance will continue to be written on a "claims made basis," which provides coverage only for claims that are presented to the insured during the policy's stated period. Sometimes, it takes years for problems to arise. Without assurance of coverage for the indefinite period of potential risk -- these policies are completely inadequate.

America, as we all know, is becoming an increasingly litigious society. There were approximately 240,000 cases filed in the federal courts alone, and there are now 10 million civil cases filed in all courts annually. Since 1970, there have been approximately 220 verdicts of more than $1 million in jury cases. The only lasting solution to the liability crisis must be Tort reform

In my personal experience, with a new firm started in 1983, the coverage is inadequate, the rates are ridiculously high, and we were lucky to obtain a policy. My partner and I have a combined total of 60 years experience and have never been sued, but our application was inititally rejected -- because in describing our practice, I had used the word "toxics." Ultimately, after much argument, we were offered $100,000 coverage (almost worthless) at a rate that amounted to 15% of our first year revenues. For 1985, as a percent of gross fee income, our quotes for professional liability insurance ranged from 3.2% for $100,000 limits with a $10,000 deductible, up to 7.7% for $1,000,000 limits with a $2,000 deductible.

What has happen to a small civil engineering and surveying firm in Rhode Island is typical of the problems that small firms face. This firm, which had about 20 total employees last year, brought in about $800,000 in gross receipts. After all expenses, including normal draws by the partners, a profit of about $75,000 was left. Last year this firm paid $12,000 for its professional liability insurance coverage; this year the same coverage cost $39,000. And a 35-40% increase in its rate is anticipated to next year. And this is for a firm that paid one claim in the last 12 years.

When the partners in a firm of this size see that their professional liability insurance payments alone equal about half of their anticipated profits, they tend to lose their entrepreneurial spirit. There is little incentive left; they could make more money in straight salaries at large firms.

The legal framework that has evolved since the 1940's has led the general public to become excessively lenient in dealing with the claims of persons for damages, with less and less concern over the fault of the defendant. Plaintiffs' awards are increasingly based on the defendant's ability to pay -- the "deep pocket" philosophy. Juries are basing judgments on "who has the money" or "who is insured" rather than "who is at fault?"

Congress also established a strict, joint and several liability standard under the Superfund Act for any party that owns, generates, or tranports hazardous waste.The Environmental Protection Agency sought this authority in order to force voluntary compliance for cleanups by responsible parties. However, response action contractors (engineers, architects, surveyors and construction firms) have now become subject to this strict liability, by virtue of their contact with a hazardous waste site. The law needs to differentiate between those who created the toxic hazards in the first place and those who are trying to remedy them. Otherwise, who except a fool will be willing to tackle the needed cleanup?

When dealing in toxic waste cleanup, the risks cannot be calculated. Because of the undefined scope of the risks, the current litigious environment in the country, the paranoia associated with toxic waste and the tremendous court damage awards, the insurance industry has made a business decision not to participate in this market. The sweeping language used to exclude this coverage is so broad that all environmental engineering design -- which inevitably involves "pollution" or "pollutants" to some extent -- may have now lost its insurance. Even before the abandonment of this market, however, the insurance policies that were being offered were, for a variety of reasons, inadequate to cover toxic waste cleanup projects. Consequently, even if the insurance industry were willing today to provide traditional insurance coverage, it would not offer the protection that response action contractors will need, if they are to participate in numbers large enough to create competition in this market.

In reauthorizing the Superfund Act this year, the House and Senate are addressing the lack of insurance coverage by proposing a government-sponsored indemnification program would allow qualified response action contractors to pursue this market, but there are many questions remaining to be answered concerning how the limits would be set. Obviously, the Congress which has passed Gramm-Rudman does not intend to offer a blank check to anyone -- even to those who may be found in court to have been damaged by a Superfund site.

The legislation would also permit the establishment of risk-retention groups or self-insurance corporations. We doubt that many engineering firms would be able to utilize this option. he capital and expertise simply are not available in this essentially small-business sector of the economy. Even with sufficient resources, risk-retention groups would take considerable time to establish, and this would delay progress on the cleanup of toxic waste dumps.

Indemnification is only a short-term and partial solution to the insurance crisis. The elimination of the dangers of toxic waste and asbestos from the environment, and the continued efforts to control air and water pollution, are all in the best interests of the nation's health and safety. Under the circumstances, until we have realistic tort reform, the federal government may have to become the insurer of last resort in order to allow these programs to proceed.

In the long run, small business needs insurance in order to mitigate the risks associated with certain jobs. Insurance underwriters identify these risks through actuarial history and offer appropriate insurance coverage at a marketable price. Our efforts at tort reform in this subject area must be aimed at providing reasonable awards to victims for damages to body or property, from a certain time that a project is substantially completed, if or when some responsible entity is found to be at fault.

Unless the Congress decides to use tax money to compensate victims where there has been no determination of fault, we need to recognize that some victims will not be compensated. The current insurance crisis demonstrates that the international insurance industry will not allow the U.S. Courts to reach into their deep pockets, regardless of fault, just because the pockets are deep.

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Statement of

MARIA DENNISON

VICE PRESIDENT, SPORTING GOODS MANUFACTURERS ASSOCIATION

for the

SENATE SMALL BUSINESS COMMITTEE

hearings on the

IMPACT OF THE INSURANCE LIABILITY CRISIS

ON SMALL BUSINESS

February 20, 1986

Mr. Chairman. The Sporting Goods Manufacturers Association is a national trade association, that together with its sister umbrella organizations, represents approximately 3,900 U.S. manufacturers and distributors of athletic clothing, footwear and sporting goods equipment. We are a $14 billion industry wholesale, composed of vertical subsegments, with the majority of companies having sales in the $1 - 25 million range. Although our industry is small when compared with other American industries, it is responsible for producing the instruments of action that provide tens of millions of Americans with recreational enjoyment, hundreds of thousands of workers with jobs, and cities and towns across the country with revenues from professional sporting events, sports clubs and retail stores.

We greatly appreciate this opportunity to describe for you the "product liability mess," which impacts heavily upon our industry and threatens the survival of sports in America.

Ten years ago there were at least 18 manufacturers of competitive varsity football helmets. Today there are only two. In 1980, the wholesale cost of a football helmet was $45, with manufacturers estimating product liability insurance and legal costs representing $11 of the $45. In 1985, product liability insurance and legal costs represent more than the combined cost of labor, materials and overhead in the manufacture of football helmets. The price of product liability insurance and litigation has curtailed the growth of the football helmet industry, especially in the manufacture of product for youth programs and the high school institutional market.

Helmet prices, because of the product liability situation, have become too prohibitive a cost to bear.

Yet the football helmet industry is not the only segment that is suffering from the product liability crunch. Gymnastic and exercise equipment companies are also finding great difficulty in getting product liability insurance coverage. We have been told that coverage for gymnastic club institutions is at a critical level, such that in the next three months, we could see a shaking out of the industry.

A company that was a pioneer of hockey protective equipment--helmets, shinguards, goalie guards and chest protectors--no longer produces these lines. The only available protective product in the sport is produced by the Canadians, Swedes and Czechs. Other American companies that had been one-time producers of hockey equipment have also dropped their lines.

Product liability premium increases of 200-500 percent are forcing a minimum of 20 percent of small diving product manufacturers to go bare. The result is that one good suit will bankrupt the companies. These companies will not get retailers to buy their product without a certificate of insurance. The product liability insurance crisis is so great that some dive equipment manufacturers are considering dropping their life-support product lines.

Ice skating rinks around the country are being forced to close their doors as 50 percent report they cannot get liability coverage. And amateur youth sports organizations may be forced to disband leagues and teams since they cannot absorb sports liability insurance premium hikes. As an example, the Amateur Softball Association is seeing its liability premium go from $7,000 in 1985 to $150,000 in 1986.

The product liability problem has the potential to kill amateur youth sports in this country. We are now seeing many schools having difficulty in obtaining liability insurance. As a result, they are eliminating their school sports programs. This has a devastating effect on the institutional market of our manufacturers, and the opportunity for kids in America to participate in sports.

The U.S. National Park Service is presently reviewing all of its contracts with concessionaires. High risk outfitters like canoe, raft and horseback providers are finding insurance both unavailable and unaffordable, as are ski areas. The result: potential suspension of operations and bankruptcy of small businesses.

The product liability problem in sports is not an isolated problem. Its economic impact can be felt by manufacturers, retailers, schools, leagues, athletes, and the like. If reform of our country's product liability laws does not take place, the American economy and American people stand to lose much more than "fun and games."

Uniformity in the tort litigation system is necessary to facilitate trade and commerce, to prevent speculation in product liability insurance rates, to insure that interstate commerce is not impeded by confusing requirements, to clarify grounds for lawsuits and to cut legal costs which result from the chaos generated by 50 different state laws.

What are some preventive measures that companies are trying to take to stay in business? If they have the resources, they're developing self-insurance structures; if they cannot get or cannot afford insurance coverage, they're going bare, hoping that the lawyers will not see them as a deep-pocket.

Some are dropping product lines that produce high exposure. And in the extreme, some are forming new companies, whereby their assets are not in jeopardy from product lines that pose high risk. These strategies are detrimental to business and ultimately they are detrimental to the consumer, who will not be able to be compensated for a legitimate injury, or will have to pay a higher price for equipment, or will not have equipment available.

For American business, the state of the present product liability crisis is inhibiting its ability to produce new product with new technology. The sporting good manufacturer is finding that his competitive ability against foreign producers is becoming less and less, as their liability costs as a percentage of sales are negligible and they carry no long tail of liability.

We need a Federal Products Liability bill. We need an insurance industry that will insure risk and work with manufacturers in structuring coverage and defending claims. Settling frivolous claims shares equal billing with strict liability in torts, making the sporting goods industry an easy mark for the trial bar.

A judicial system out of balance is allowing the legal profession's greed to outweigh its fair play, and an insurance industry to red-line entire industries. It is unfortunate to make the analogy that a referee on a football field hands out more justice every Sunday, than a judge does in the courtroom every day under the present liability system. Justice isn't the name of the game. Who wins and who loses is. And the one who loses is the one with the deepest pockets.

As one writer has observed, "Imagine a football game where the rules change every two yards. That would mean 50 sets of rules apply, depending on the location of the ball. Sound difficult? Not apparently much more so than the nation's product liability law problem." For American sports, the two-minute warning is about to sound. We've studied the product liability issue to death. We need to have Congress act.

NTDRA
NATIONAL TIRE DEALERS & RETREADERS ASSOCIATION, INC.
Suite 400, 1250 Eye Street, N.W., Washington, D.C. 20005 (202) 789-2300 (800) 368-5757

Office of the Executive Vice President

March 4, 1986

Senator Lowell Weicker, Jr.
Chairman, Committee on Small Business
428A Russell Senate Office Building
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

As Executive Vice President of the National Tire Dealers and Retreaders Association, representing over 5000 independent tire dealers and retreaders nationwide, I wish to submit the following comments for the record relative to your committee's February 20th hearing on the "cost and availability of liability insurance."

Let me commend you, Mr. Chairman, for convening this hearing. We recognize that other committees of the Congress are holding hearings on the overall liability insurance crisis. However, probably no other sector of our economy is being so adversely impacted by the unaffordability and unavailability of liability insurance as the small business sector. Your committee's focusing on the liability insurance problems of small business is essential to Congressional understanding of the perilous position in which the nation's small business sector now finds itself.

Small business is presently caught in an unprecedented squeeze between courts and legislators who liberalize the tort system by expanding historical concepts of liability; juries, which render astronomical awards based more on emotion than reason; insurance companies, some of whom seek to force the insured to pay for the company's faulty business judgements with excessive premiums; and trial lawyers, who to enrich themselves have foisted on society the concept that an injured party should be made whole whether or not there is evidence of fault or negligence

The average tire dealer and retreader, like other small business men and women, cannot afford to pay the cost of liability insurance coverage without threatening his very capacity to make a profit. And in many instances he cannot find

President LOUIS KARRAS · President Elect E. R. BROWN · 1st Vice President DON PERRY · 2nd Vice President JOE DePAOLIS · Treasurer JOHN SHIMER · Corporate Secretary JERRY BAUER · Executive Vice President PHILIP P. FRIEDLANDER, JR.

adequate coverage at any cost. Can he afford to "go bare"? Of course not! The first significant claim could bankrupt his business. And yet that is what some of our members have been forced to do. Or worse still some retreaders have closed their retreading operations because they cannot afford the cost of insurance.

Some argue, Mr. Chairman, that small business should just pass the cost along to the consumer. For many small tire dealers in a highly competitive market that option is unavailable. Many of the nation's largest corporations are able to pool their resources and establish off shore "captive" insurance companies. Regrettably this option is not an easily achievable one for small business even with the assistance of a trade association like NTDRA. The reason is the large amount of capital that is required, capital which small businesses have so little of. And that which they have is needed for inventory purchases, and updating facilities in order to remain competitive.

Mr. Chairman, Congress has been studying the growing liability insurance problem for more years than I care to remember. Senator Kasten has been fighting the battle for product liability reform for five years now or longer. NTDRA has testified in support of both S.100 and its predecessor S. 44. State legislatures have been debating tort reform with increasing frequency and NTDRA believes tort reform at the federal and state level would be a step in the right direction. Indeed many state tire dealer and retreader associations have worked for tort reform at the state level. But reform has come slowly, if at all, because the membership of many state legislatures is largely comprised of trial lawyers who have a vested financial interest in maintaining the status quo.

Almost every week NTDRA receives an invitation to another symposium on the liability insurance crisis. And yet the problem continues unabated and may well be getting worse.

Mr. Chairman, if relief is to come for many small businesses it is going to have to come from the Federal Government. It is unrealistic for the nation's small business sector to look for timely relief to 50 state legislatures or 50 state court systems. And no small business man or woman is so naive as to hope for relief at the hands of the insurance industry or the trial lawyers.

Mr. Chairman, NTDRA would respectfully request that your committee investigate the feasibility of the Federal government establishing and funding an entity which for lack of a better name we will call the Federal Small Business Insurance Corporation. The purpose of this new government entity would be to make below market loans to small business trade associations or consortiums of small businesses so that they, like larger corporations, could have the option of self insurance or of establishing their own "captive".

Loans could be made on a matching basis, that is the loan applicant would be required to come up with half the funds necessary to capitalize the financial undertaking. And let me repeat, these funds would be loans, not grants. The Federal government would simply be aiding small business temporarily to capitalize for purposes of self insurance. The government would be providing aid at a time when, for many small businesses, liability insurance many not be available at any price from traditional sources.

We recognize that to a Congress operating under the restrictions of Gramm-Rudman, the idea of establishing a new government program may have less than overwhelming appeal at first. But consider the alternative. Look at the unacceptable low rate of economic growth in the last quarter of 1985. Then consider that small business has been the driving engine of the current economic recovery. If high insurance premiums destroy the profitability of much of the nation's small business sector, if unavailability of insurance exposes an ever larger segment of the small business community to the prospects of bankruptcy, then the prospects of continued national economic growth will be bleak indeed. Increased payments to the unemployed workers of the small business sector and reduced federal tax revenues from small businesses which have closed their doors will be a grim reality.

Mr. Chairman, NTDRA believes this concept has merit. We are currently exploring the setting up of a "captive" insurance company and know the major hurdle which initial capitalization of a "captive" poses for this association and its members. Other small business groups are no doubt exploring the same self insurance options and encountering the same obstacles. The concept we have proposed, Mr. Chairman, could be a partial solution which would enable the small business sector to help itself. We urge the committee to take a serious look at the concept. We would certainly be pleased to meet with you, other members of the committee, or committe staff to explore this concept further.

In conclusion we would like to again thank you for convening this important hearing and for allowing NTDRA to submit its views.

Sincerely,

Philip P. Friedlander, Jr.
Executive Vice President

NLPGA
National LP-Gas Association • 1235 Jefferson Davis Highway • Arlington, Virginia 22202 • 703-979-3563

March 18, 1986
File: 340/86-1

The Honorable Lowell Weicker, Jr.
Chairman
The Committee on Small Business
United States Senate
Washington, D.C. 20510

Dear Chairman Weicker:

The National LP-Gas Association noted with favor that the Senate Small Business Committee conducted two days of hearings on February 20 and 21, 1986, on the cost and availability of liability insurance for small businesses. As a subject critical to the future of the propane gas industry, we respectfully request that this statement and enclosures be entered into the official record of these hearings.

The members of the National LP-Gas Association (NLPGA) represent a cross-section of American business: from the largest producers of LP-gas (principally propane gas), a light hydrocarbon derived from crude oil refining and natural gas fractionation, to the smallest retailers, these 4000 member companies supply an essential fuel used by millions of homeowners for heating, cooking, and water heating. They all have been severely and seriously affected by the current crisis in insurance pricing and availability.

FEDERAL LAW ADDS TO PROBLEM

Although the extent of the impact of this crisis varies significantly according to each individual company's financial size and accident history, its effects have been exacerbated by legislation passed by Congress in 1980. Section 30 of the Motor Carrier Act of 1980 mandated that carriers of hazardous materials maintain certain minimum levels of financial responsibility. On January 1, 1985, following a five year phase in period, the full levels of financial responsibility took effect. As required by Section 30, carriers of propane gas and other hazardous materials in bulk, defined by the U.S. Department of Transportation as cargo tanks in excess of 3500 gallons water capacity, must maintain $5 million financial responsibility regardless of whether the cargo tank is operated in interstate or intrastate commerce. Cargo tanks of less than 3500 gallons capacity must be insured for $1 million if operated in interstate commerce. Section 30 also requires that the insurance cover not only personal injury and property damage but include coverage for "environmental restoration", a term left undefined in the statute.

Today, one year after implementation, the full effect of Section 30 is now being felt. Due to adverse court decisions, insurance companies are routinely excluding environmental restoration from such policies. Companies who a year ago were carrying as much as $20 million insurance are now finding it difficult, if not impossible, to even obtain $5 million. And the premiums are staggering.

SMALL BUSINESSES BEING FORCED OUT

In testimony before the Senate Small Business Committee, one small marketer from Oklahoma, Mr. Kenneth Green, noted that his insurance premiums went from $113,000 to $250,000, while his coverage dropped from $6 million to $5 million. Another company, Jubilee Gas Company, Inc. of Selma, Alabama, found it so difficult to obtain insurance that they decided to sell the business. Yet another business in Ohio had their excess insurance non-renewed last October despite a 30 year safety record that had won several awards from their insurer! They were able to obtain renewal only 8 hours before final cancellation. Their premiums increased from $13,000 to over $47,000. Indications are that it may exceed $100,000 next year. This company, a small, family business serving a few thousand homeowners dependent on propane for their heat, is now reviewing two bids to purchase the company instead of continuing the fight.

Enclosed are copies of some of the correspondence we have received from around the nation outlining the problems of propane gas dealers in this current crisis.

A RECOMMENDATION FOR IMMEDIATE RELIEF

Two immediate, alternative solutions would help propane gas dealers: (1) either repeal the $5 million statutorily-set financial responsibility requirements of Section 30 of the Motor Carrier Act of 1980; or, (2) amend Section 30 to delete the specified amount of insurance and vest in the Department of Transportation, Federal Highway Administration, authority to set appropriate levels of financial responsibility through rulemaking. We recommend either of these solutions because the safety record of this industry simply does not justify federally-established minimum levels of insurance, nor has any documented evidence ever been put forth to prove that $5 million ought to be the minimum level of insurance.

Until 1980, insurance levels for propane gas retailers and transporters were essentially the province of state regulatory authorities who handled the matter adequately. Section 30 was added in response to demands from the common carrier trucking industry for protection against new entries into the business who might not have the financial resources to maintain a viable enterprise. We support all efforts targeted at maintaining a high level of safety in over-the-road operations; however, we cannot agree that safety can be guaranteed by simply mandating certain minimum levels of financial responsibility.

The insurance industry testified in 1980 that they cannot be considered "policemen" who keep unsafe operators off the highways. The fact that a company has $5 million insurance merely indicates that they are able to afford the insurance and that there is sufficient underwriting capacity in the marketplace: it is not a guarantee of safe operations. In many states, assigned risk pools have been established by state law so that even if a company cannot obtain insurance through the regular market, they often can obtain it through assigned risk pools (although even this mechanism has broken down in this current crisis due to lack of capacity and the refusal of insurance companies to write policies covering "environmental restoration"). Therefore, it is misleading and inaccurate to claim that minimum levels of financial responsibility ensure safety. It simply is not true.

At its most recent meeting on January 31, 1986, the National Motor Carrier Advisory Committee, a federal advisory committee established by the Administrator of the Federal Highway Administration and the Secretary of Transportation, adopted a resolution calling on Congress to re-examine the provisions of Section 30 of the Motor Carrier Act of 1980 particularly with respect to the appropriate levels of insurance. A copy of that Resolution and a list of Committee members are also enclosed.

Finally, we have enclosed a copy of a letter submitted to the Senate Commerce Committee on September 14, 1984, as part of that Committee's oversight of Section 30 of the Motor Carrier Act. In this letter, we reported the results of an accident and insurance survey we conducted of our members in February 1984. Two years ago - fully one year before the current insurance crunch hit American businesses - our survey revealed:

- an enviable industry safety record which belied any alleged need for federally-mandated insurance;
- anticipated cost increases that would be staggering, even in normal times, with no corresponding benefits; and,
- a potential for actually reducing the level of operating safety by diverting scarce dollars from training, education and equipment maintenance and purchase in order to cover higher premiums.

The Federal Highway Administration's (FHwA) own statistics, as reported on page 5 of the enclosed letter to Senator Packwood, corroborate our survey findings. FHwA analyses revealed that only 6 of 32,393 accidents - two one-hundredths of one percent or a risk of 105 in a million - had aggregate societal costs in excess of $500,000. In short, there is no logical, rational justification for $5 million financial responsibility levels.

In conclusion, although we believe Section 30 to be unjustified and in need of repeal, we can support an amendment which would remove the $5 million mandate and, instead, vest in the FHwA authority to establish appropriate levels of financial responsibility through rulemaking because:

(1) it would permit a rational, deliberate rulemaking process, devoid of politics, emotion and hyperbole, which would allow for a thorough analysis of the costs and benefits of mandated insurance; and,

(2) in times of crisis such as we are now experiencing, the agency would have the flexibility to permit continued operation without the required - but temporarily unobtainable - insurance now mandated by law.

TORT REFORM

Another, more long term solution to the insurance crisis is through fundamental tort reform. Legislation has recently been introduced in the Senate in the form of S. 2046 by Senator Mitch McConnell (R-KY) entitled The Litigation Abuse Reform Act of 1986. The provisions of S.

BEST [illegible]

2046 would apply to tort actions brought in federal court and would, among other things, require periodic payments over the estimated lifetime of an individual for damage awards in excess of $100,000; provide offsets for collateral source benefits; cap non-economic losses (e.g., pain and suffering) $100,000; limit attorney fees to a sliding scale of 35% of the first $50,000 awarded, 30% of the next $50,000, 20% of the next $100,000, and 10% of those amounts in excess of $200,000; prohibit attorney contingency fees based on punitive damages; limit the award of punitive damages to willful and wanton conduct, and mandate that such damages be paid to the U.S. Treasury, not to the plaintiff; and, penalize attorneys for bringing frivolous actions or suits merely with the intention of obtaining favorable settlements with no anticipation of success at law. NLPGA supports basic tort reform legislation such as S. 2046 both in the federal and state courts as essential in order to restore sanity to the U.S. civil justice system.

CONCLUSION

On behalf of the members of the propane gas industry and the National LP-Gas Association, we urge Congress to take immediate action to relieve the pressures on propane gas marketers who are unable to obtain statutorily mandated insurance at any price or at such a cost as to be economically unjustifiable. We are calling for immediate repeal of Section 30 of the Motor Carrier Act of 1980, or amendment to vest in the Department of Transportation, Federal Highway Administration, authority to establish appropriate levels of insurance.

We also call for immediate consideration of S. 2046 and similar tort reform legislation designed to restore a tort system that provides prompt, just and full compensation to injured victims at a reasonable cost without outraging common sense notions of justice.

Respectfully submitted,

Daniel N. Myers
Vice President, Government
Relations & General Counsel

DNM:pc

Enclosure

Testimony Concerning
The Cost and Availability
of Liability Insurance for Small Business
Before The
Senate Small Business Committee
February 21, 1986

My name is Ken Green and I am President of Oklahoma Liquefied Gas Company, headquartered in Seminole, Oklahoma. I am here today speaking on an issue which is having a great impact on our company as well as our business companions across the country, liability insurance. In the next few minutes I would like to share with you the nightmarish experience our company has just been through concerning this colossal insurance dilemma.

First I would like to give a little background information on our company. Oklahoma Liquefied Gas is a medium size independent propane distributor serving some 5000 residential and commercial accounts with propane gas in central Oklahoma. This propane is used mainly for home and industrial uses when natural gas is not available, however there are also other uses such as motor fuel and recreational uses. We also wholesale and truck propane gas to other dealers throughout Oklahoma. Our total yearly revenue is approximately $6,000,000.

Our insurance problems began in September of 1985 when we received a cancellation notice from the insurance carrier at that time. The cancellation was to take effect December 20, 1985, the anniversary date of the policy. At this time we were in the first year of a three year contract. However, as it turned out, only ten days notice was required to cancel this contract. The reason for this cancellation was stated as the inability to renew with the reinsurance company who was getting out of this particular market entirely.

As gloomy as it might sound, this news did not alarm us at that time. We had already began looking into coverage for 1986 and had been assured by several agencies that coverage for a company with our track record would be no problem. This track record refers to our loss ratio, losses paid to premiums earned, over the three previous years. The table below illustrates these numbers.

YEAR	PREMIUM EARNED	LOSSES & EXPENSES PAID	LOSS RATIO
1983	$169,243	$28,862	.171
1984	88,589	-0-	.000
1985	113,018	22,234	.197
TOTALS	$370,850	$51,096	.138

With a total of six large agencies confidently shopping nationwide and this loss ratio, we felt it would be no problem to locate adequate and affordable coverage. To us affordable meant no more than an anticipated 25 to 30 percent premium increase.

Over the next two and one half months we discovered that finding coverage, at any price, was far from easy. One by one the different agencies began to drop out unable to find coverage. It seemed a few companies had some interest in our business but could not get the reinsurance necessary to write the business until after the first of the next year, too late for us. As it turned out our renewal was coming due at the worse possible time.

On the afternoon of December 19th, the final day of the existing policy, we had decided we would close business the next day and go to the State Insurance fund for help. Fortunately for us, as it turned out, this was not necessary. Two other options came available with one being acceptable. One option came available when one of the agencies was able to secure coverage from a specialty insurance company. The shocking news was the premium for this coverage. For only 5% of the coverage we had had, $300,000 limits vs. $6,000,000 limits, we were looking at a premium of $417,000 vs. $113,018 for the previous year. This increase by the way was more than our total projected cash flow for the entire year.

The second option, which turned out to be our solution, came about when we found out the Association Insurance Company of Texas was licensed to do business in Oklahoma. This group had been doing business in Texas since 1972 with propane dealers throughout the State. They had applied to do business in Oklahoma three months earlier and just three days prior to our deadline were granted approval to do so. Anticipating this licensing, we had mailed an application just in case it came through in time to help us. Just six hours before our coverage terminated we were bound by the Texas group.

At this time we had no idea what our premiums would be, but felt sure they would be much less than the $417,000 quote and would give us adequate coverage. Just recently we received our final premium figures. With one million less coverage, $5,000,000 vs. $6,000,000 and higher deductibles, our premiums increased to $250,000 corpared to the $113,018 for 1985.

Now that we have the coverage, we have begun the process of figuring out how we can pay the premiums. The insurance problem coupled with the existing economic depression in our state has caused us to go back to the drawing board on our 1986 budget. We have already eliminated nearly 25 per cent of our work force, ten employees in the last 45 days. We have plans to park some of our equipment, remove insurance, and attempt to liquidate it. In some cases the new insurance premiums actually make some equipment too costly to operate. This is especially true of the equipment which we are required by Section 30 of the Motor Carrier Act of 1980 to carry $5,000,000 of insurance coverage on.

As we communicate with other propane dealers across the country we find they too are experiencing similar crisis concerning their liability insurance. One dealer in Kansas has received a preliminary quote of over $700,000 for his new coverage compared to $200,000 for his existing coverage. Others are finding adequate coverage nearly impossible to locate. In Oklahoma, dealers view the insurance crisis as having a similar negative impact as the current depressed oil prices.

We feel the Federal Government can assist propane dealers like ourselves immediately by reducing the $5,000,000 insurance limit required by Section 30 of the Motor Carrier Act of 1980 to $1,000,000. We have in recent years carried in excess of $5,000,000 of coverage and were doing so before it was law. However, we feel the cost and/or availibility will make this law virtually impossible to comply with.

This is only a partial answer to the problem and only effects a certain segment of our industry. We feel as do other businessmen we have conversed with, that the long term solution is to control insurance rates through a more judicious handling of settlements with a move towards a fair and reasonable limitation of liability lawsuits.

This concludes my testimony and I'll be happy to answer questions.

[illegible] AVAILABLE

NEWPORT COUNTY BOTTLED GAS CO., INC.

Suburban Propane

50 Underwood Lane
Middletown, Rhode Island 02840
(401) 847-6878

March 4, 1986

The Honorable John H. Chafee
U.S. Senate
Washington, D.C. 20510

Dear Senator Chafee:

As you know, there exists a major problem in the country today for many industries to obtain liability insurance, at any cost.

We are a small family owned propane dealership, and have found it impossible, (through no fault of our own) to get any insurance company to renew our general liability policy.

Apparently huge court settlements being awarded to accident victims have made propane dealers and distributors "Untouchable" in the eyes of insurance companies and their brokers.

We have run our business successfully for over 25 years, and have always had insurance. Now we feel uncomfortable operating without it.

We respectfully request your help in finding a solution to this problem, and thank you for your attention to this matter.

Very truly yours,

David A. Sherman

David A. Sherman
President

Sands
PROPANE, INC.

February 25, 1986

Congressman Jim Wright
1236 Longworth House Office Building
Washington, D. C. 20515

Dear Congressman Wright:

The Motor Carrier Act of 1980 placed on members of our industry a requirement to carry at least $5 million in liability insurance. The liquified petroleum gas industry, at the time, opposed the requirement because of its excellent safety record, but the law was enacted, nevertheless.

Now, with the present liability crunch affecting our country, many propane dealers throughout Texas, and the United States, are unable to fulfill the insurance requirement of the law (please see the enclosed non-renewal notice received by our office.)

If I am unable to find the required insurance I know of at least 3,000 families in North Central Texas that will be without fuel. I urge you to contact the Federal Highway Administration and/or DOT in an effort to relax these requirements so that we may continue to supply the needs of this country with a very important energy source.

The National L P Gas Association's office in Washington (703-979-3563) can supply you with pertinent data regarding this very serious problem to the rural dwellers of this country.

Thank you.

Yours truly,

Mike Sands

Mike Sands

P. O. DRAWER J • WEATHERFORD, TEXAS 76086 • 817-594-3808

NOTICE OF CANCELLATION OR NONRENEWAL

OF Commercial Umbrella Liability

KIND OF POLICY

POLICY NO.	ISSUED THROUGH AGENCY OR OFFICE AT	CANCELLATION OR TERMINATION WILL TAKE EFFECT AT (DATE) (HOUR—STANDARD TIME)	DATE OF NOTICE
RU 417964	Weatherford, Texas	April 01, 1986 12:01 A.M.	2-7-86 sb

INSURANCE COMPANY Ranger Insurance Co.

NAME AND ADDRESS OF INSURED
Sands Propane, Inc.
P.O. Drawer J.
Weatherford, Texas 76080

(Applicable item marked ☒)

CANCELLATION ☐ You are hereby notified in accordance with the terms and conditions of the above mentioned policy that your insurance will cease at and from the hour and date mentioned above.

If the premium has been paid, premium adjustment will be made as soon as practicable after cancellation becomes effective.

If the premium has not been paid, a bill for the premium earned to the time of cancellation will be forwarded in due course.

☐ You are hereby notified in accordance with the terms and conditions of the above mentioned policy that your insurance will cease at and from the hour and date mentioned above due to nonpayment of premium.

A bill for the premium earned to the time of cancellation will be forwarded in due course.

NON RENEWAL ☒ You are hereby notified in accordance with the terms and conditions of the above mentioned policy that the above mentioned policy will expire effective at and from the hour and date mentioned above and the policy will NOT be renewed. Company no longer provides coverage

IMPORTANT NOTICE ☐ In compliance with the Fair Credit Reporting Act (Public Law 91-508), you are hereby informed that the action taken above is being taken wholly or partly because of information contained in a consumer report from the following consumer reporting agency

NAME

ADDRESS

[illegible] © [illegible]

INSURED'S COPY

Mike Mahoney
Authorized Representative
Mike Mahoney

BLE

ALBUQUERQUE HIGHWAY

LP-GAS SERVICE

PHONES 471-2863
471-2864

COTTON BUTANE CO., INC.
P.O. BOX 4037
SANTA FE, NEW MEXICO 87502

February 17, 1986

Daniel N. Myers
National LP-Gas Association
1235 Jefferson Davis Highway
Arlington, VA 22202

Dear Mr. Myers:

As an independent LP Gas dealer and gasoline distributor, we have been hit hard with outrageous increases in our annual Comprehensive General Liability premiums. This national liability insurance crisis, and it is a crisis, is forcing many businesses to close down all together. And if our premiums continue to skyrocket in 1987 as they have in 1985 and 1986, it is very likely that we will be forced to close our doors also.

In 1984 our annual premium was $43,476. In 1985 we were slapped with a $74,681 annual premium; up 72% but the least of three or four bids. Three weeks ago we were presented with our one and only bid for 1986 from Ranger Insurance Co., and the total was $170,213; up a whopping 128% over last year, and a staggering 292% over the last two years !!! When will this monstrosity end ?

Much of the increase is due to Section 30 of the 1980 Motor Carrier Act. This law requires $5 million in liability insurance for tracks that transport various hazardous materials. In Ranger's proposal, the Comprehensive General Liability premiums at the $1 million level totaled $105,113 , the $3 million level rose to $122,213 , and to get a $5 million limit it will cost us $170,213. The additional $2 million excess layer from $3 million to $5 million cost $48,000 , which is more than our total premium was in 1984.

In short, we need relief NOW! The major LP Gas companies that operate all over the country have the advantage of a large menu to choose from, and the insurance companies are forced to offer competitive rates. Small independents are limited to those insurance companies that have a license to offer coverage within the state.

ALBUQUERQUE HIGHWAY

LP-GAS SERVICE

PHONES 471-2863
471-2864

COTTON BUTANE CO., INC.
P.O. BOX 4037
SANTA FE, NEW MEXICO 87502

February 17, 1986
Page 2

For the sake of all business, but especially for small independents, please take the necessary steps to encourage Congress to amend or relax the provisions of Section 30 of the 1980 Motor Carrier Act and impress upon Congress the seriousness of this crisis. The problems from Worker's Compensation in New Mexico have had a strong effect on us, but that compounded by the $5 million limit in liability is simply overwhelming our company.

We would greatly appreciate any effort you could give to help rescind Section 30 of the 1980 Motor Carrier Act and update New Mexico's Worker's Compensation program. Enclosed is a bar graph illustrating what has happened, and what could happen, to our liability premiums.

Thank you for your time and consideration.

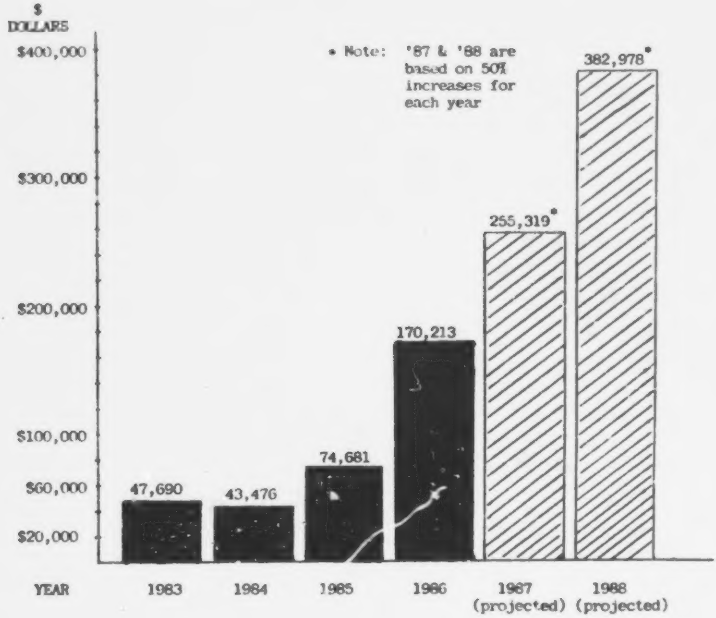
Sincerely,

Gary B. Cotton

Gary B. Cotton, Vice President

GBC/id
Enclosure

COMPREHENSIVE GENERAL LIABILILY
ANNUAL PREMIUMS



* Note: '87 & '88 are based on 50% increases for each year

RUTHHART SMITH CORP.
Insurance - Bonding
Telephone 215 - 868-5121
530 West Broad Street
P. O. Box 4085
Bethlehem, PA 18018

February 14, 1986

Mr. Daniel Myers
1235 Jefferson Davis Highway
Suite #702
Arlington, Virginia 22202

Re: Insurance Requirements and Availability

Dear Mr. Myers,

We are insurance brokers for many propane dealers who are experiencing an absolute crisis in availability and pricing in the insurance market place. The demise of the propane industry and general safety and rights of innocent third party victims could be imminent if corrective action is not taken at once. The reinsurance market place is causing huge price increases which are causing some dealers to go bare without insurance. We have seen many cases of 300 o/o increases, $1 million layers of liability costing $12,000 per $1 million, $50,000 minimum premiums etc. It would seem that the government should be pressured into dropping requirements from $5,000,000 to $2 million. The availibility is just not within reason. Our legislators have to be made aware since energy is in the public safety"s best interest. Insurance is regulated by states but federal mandates require $5 million coverage.

We are members of your association and now before it is too late, I urge you to take action. I would even suggest your national advertising to alert the consumers to be aware of this problem. Propane dealers going out of business will create a fixed price for the consumer who will not have a place to shop for energy. The glut of fuel is polarized by the cost of insurance. They do not go hand in hand. I would appreciate your comments.

Sincerely,

William F. Ihrie, Jr.
William F. Ihrie, Jr. CPCU
President

cc: Mr. Robert Nicholson
Mr. Brian Clayton
Mr. Thomas Lopatofsky

YOUR Independent Insurance AGENT
SERVES YOU FIRST

JUBILEE GAS COMPANY, INC.

Propane Gas Service
Gas Appliances
LP Gas Carburetion

Highway 80 West
Selma, Alabama 36701
Phone 874-6674

P.O. Box 94
Maplesville, Alabama 36750
Phone 366-2566

2-28-86

DEAR DAN

FOR SOME OF US THE HASSLE BECOMES TOO GREAT.

I TALKED WITH YOU IN NOV.-MAYBE OCT. 85 - WHEN THE MOTOR CARRIERS ACT OF 1980 WAS BROUGHT TO MY ATTENTION AND DIXIE PIPELINE WAS REQUIRING THE FIVE MILLION LIABILITY COVERAGE TO ENTER THEIR TERMINALS.

IN DECEMBER I SOLD MY BUSINESS TO BLOSSMAN GAS INC. I WANTED YOU TO KNOW THAT PART OF MY DECISION TO GET OUT OF THE BUSINESS WAS BASED ON THE UNFAIR (I THINK) PROVISIONS OF THE 1980 MOTOR CARRIERS ACT.

CARRY ON THE FIGHT.

Harold D Gregg, Pres.
Jubilee Gas Co. Inc

BEST COPY

NATIONAL LP-GAS ASSOCIATION
1235 JEFFERSON DAVIS HWY., STE. 702 NLPGA ARLINGTON, VIRGINIA 22202

DANIEL N. MYERS
VICE PRESIDENT GOVERNMENT RELATIONS
& GENERAL COUNSEL
Phone 703/979-3563

September 14, 1984
File: 285.41/84-11

The Honorable Bob Packwood
Chairman
Committee on Commerce, Science and
Transportation
United States Senate
Washington, D.C. 20510

Dear Senator Packwood:

The National LP-Gas Association (NLPGA) offers the following comments on Section 30 of the Motor Carrier Act of 1980 and requests that they be incorporated into the record of the oversight hearing scheduled by your Committee for September 18, 1984.

NLPGA is the national trade association of the LP-gas (principally propane) industry with a membership of about 4100 including 47 affiliated state and regional LP-gas associations representing all 50 states. NLPGA represents all segments of the propane industry including producers, transporters, wholesalers and retailers of propane gas, as well as the manufacturers and distributors of associated equipment and appliances. Our members own over 25,000 transport and delivery trucks operating in both interstate and intrastate commerce, in private and for-hire carriage. Over 93% of the propane shipped in the United States travels by tank truck at one time or another.

NLPGA has consistently registered its opposition to Section 30 of the Motor Carrier Act of 1980, a provision adopted without benefit of hearings or any documented evidence of need. If Congress believes there is merit in mandatory minimum levels of financial responsibility, then we suggest and support amendment to Section 30 to grant discretionary authority to the Secretary of Transportation to establish the appropriate levels. Such discretionary authority would provide an opportunity to establish limits based on a record of proven need with flexibility to adjust limits as needs change.

CONGRESS WAS SOLD A BILL OF GOODS

Quite frankly, Congress was sold a bill of goods in 1980. Congress was told that deregulation would open the door for any huckster to enter the trucking industry and make a quick profit with little or no concern for truck safety. Images of outmoded and unsafe rigs; of unskilled, illiterate and poorly trained drivers; and of callous, money-hungry entrepreneurs were portrayed against a montage of past trucking accidents. Congress was told that the best way to prevent this was to mandate a certain minimum level of financial responsibility: only the safe operators could get insurance and the "bad actors" would be forced off the road by the insurance companies. Nothing could be further from the truth.

Due to a residual market mechanism, any trucker denied coverage by three insurance companies and who has a valid driver's license can obtain insurance. The American Insurance Association has repeatedly testified that insurance is available to all, no matter what their safety record may be, through assigned risk pools; that there is no correlation between enhanced safety and levels of insurance; that the insurance industry does not wish to nor can it act as surrogate regulators of the motor carrier industry; and, that safety may even be compromised as scarce financial resources are diverted from truck maintenance and driver education to pay higher insurance premiums.

NLPGA SURVEY

In an effort to document this latter point - that money previously spent on truck safety may be diverted to cover the higher premiums resulting from Congressionally-mandated minimum levels of financial responsibility - in February 1984, NLPGA surveyed its smaller marketer members, those with annual sales of propane under 2 million gallons. The purpose of the survey was to obtain statistical data on truck operations, safety and insurance levels. Responses to the questionnaire were received from 720 companies, 27% of the 2672 companies surveyed.

The survey was limited to the smaller propane marketers for two reasons: first, smaller companies are less likely to carry the statutory level of insurance required by the Motor Carrier Act of 1980; and, second, the cost of insurance, safety training, driver education and truck maintenance typically represents, percentage wise, a larger budget item for small companies than large companies. As a result, we believe this report shows a conservative picture of the propane industry: figures for safety-related expenditures have not been inflated by a few high-budget companies.

The 720 respondents averaged 25 years in the propane business.

A total of 54.5 million miles per year of hazardous materials transportation is represented, or 75,500 miles per company. The total number of trucks owned by the respondents is 219 "bulk" trucks (over 3500 gallons water capacity) and 2090 bobtails (trucks exceeding 10,000 pounds gross vehicle weight rating (gvwr), but under 3500 gallons w.c.). The statute exempts vehicles under 10,000 pounds gvwr. The average number of trucks per respondent is 3.2 delivering an average one million gallons annually. The total annual sales represented by the survey is three-quarters of a billion gallons to approximately 1 million customers.

Industry Safety Expenditures

One aspect of the survey attempted to ascertain the small propane marketer's commitment to safety. Thus, respondents were asked how much is budgeted for truck maintenance and purchases, driver training, and safety training. The respondents reported an average annual budget for truck purchases of $16,800; truck maintenance, $16,200; driver training, $1,100; and, safety training, $850. The current average annual cost of insurance for respondents is $10,500. This cost will increase markedly when the Congressionally-mandated minimum levels of financial responsibility are fully implemented on January 1, 1985.

For example, companies operating bobtails are currently required to demonstrate $500,000 minimum financial responsibility An increase to $1,000,000 as required by the Act will mean an additional $2165 in premiums, per company: an increase of 20%. Bulk vehicles (transports) must now be insured for $1,000,000; an increase to $5,000,000 will increase premium costs by an average of $3066 per company, or 30%.

How Will Industry Cover Cost Increases?

Cost increases of 20% to 30% are not insignificant and cannot merely be absorbed. The natural reaction may be to assume that these expenditures will be merely another cost of doing business and will be passed on to the customer; unfortunately for the small businessman, various factors militate against a mere passthrough. Thus, for example, competition, the general state of the economy, and other overhead cost increases will work to deter an automatic price increase to cover each new cost.

We wanted to find out what would be the response of marketers facing a cost increase of this magnitude. Thus, we asked the following question:

> "Assuming you are required to increase your insurance premiums to reach the statutory levels, in what portion(s) of your operations, if any, would you be forced to reduce expenditures?"

Since we did not suggest categories where expenditures might be reduced, we had a variety of answers. The following were the most frequent responses, listed by the percentage of responses:

1. Reduce truck purchases - 25%.
2. Reduce truck maintenance - 12%.
3. Reduce driver training - 10.5%.
4. Reduce safety training - 9.3%.
5. Increase price of product - 7.5%.

These figures clearly indicate that Congressionally mandated higher levels of insurance may have an adverse impact on safety in the propane industry. Thus, for example, 37% of the respondents will divert money from equipment purchase and maintenance to buy more insurance. Another 19.8% will reduce training programs to pay for this Congressionally required insurance. Out of 720 small propane marketers serving a million customers annually and traveling 54.5 million miles, 409 will begin operating increasingly older and less well-maintained trucks with poorer trained drivers, all in the name of safety!

This belies the concept behind Section 30 of the Motor Carrier Act of 1980 that higher insurance increases safety. By analogy we can compare this to life insurance. Is a person who is insured for $50,000 less apt to die than a person insured for $1,000,000? Insurance has no bearing on the question. What, however, if the one insured for $1,000,000 cannot afford preventive maintenance (annual physicals) because they spend their available funds on insurance premiums? At this point the insurance may make their life less safe than that of the person who carries less insurance and gets annual physicals (preventive maintenance).

Small Marketer Accident History

Traveling an average of 54.5 million miles per year, the 720 respondents have had accidents. These marketers reported a total of 1000 accidents in which their trucks have been involved over the past 10 years. Of these 1000 reported accidents, 300 resulted in the payment of a judgment, settlement or paid claim. Of these 300 judgments, settlements or paid claims, 282 or 94% amounted to no more than $50,000. Indeed, 225 or 75% were under $5,000!

Since Congress focused on members of the hazardous materials industry - and liquefied gas carriers in particular - for special treatment, it is important to zero in on those accidents where there was a release of product. After all, one of the most frequently reported forms of accident was trucks hitting low-hanging tree limbs: hardly a threat to society. Our survey asked for the total number of accidents ever (not confined to the past 10 years) in which product was released. The answer was 17. Of those seventeen, in only 6 did the release of the product contribute to damages. Of those 6, one resulted in $4000 damages, one caused $3000 in damages, one was covered by workman's compensation, one is not yet settled, and the sixth resulted in no damages.

Congress Must Wake Up

We believe our survey tells a clear story:

(1) the accident history of the propane industry demonstrates neither a tendency toward sloppy handling nor a record of repeated catastrophic incidents and uncompensated victims;

(2) the added costs to industry will be substantial and, again, are not offset by any corresponding benefits; and,

(3) the net result may be an actual reduction in the level of operating safety in order to cover the higher premium costs.

The American Insurance Association submitted corroborating data to the Federal Highway Administration obtained from the Insurance Service Office (ISO), the statistical agent representing 75% of the total commercial automobile market. The ISO data, reported in the July 2, 1984, Federal Register, page 27290, reflect commercial autombile losses (including public autos, garage vehicles and trucks) incurred from January 1, 1977, through September 30, 1981. There were 1,908,861 paid losses, 839 of which were settled for between $250,000 and $500,000. Only 157 losses were settled for over $500,000. That amounts to one-one hundredths of one percent!

In that same Federal Register notice which was the extension of the lower phase-in levels of the financial responsibility rules through the end of 1984, the Federal Highway Administration (FHwA) published their own statistical findings. They analyzed 32,393 accidents reported in 1982 to determine their "societal costs", an aggregate of their fatalities, injuries and value of property damage. The FHwA analyses revealed that only 6 of 32,393 accidents (two one-hundredths of one percent or a risk of 105 in a million) had aggregate societal costs in excess of $500,000. In 1982, only three accidents were reported with property damage equal to or greater than $1 million: in these three accidents, the average societal costs amounted to $1.4 million.

CONCLUSION

NLPGA urges the Senate Commerce Committee to begin work immediately to either rescind Section 30 in its entirety or to enact legislative recommendations offered by the U.S. Department of Transportation which would permit the establishment of appropriate financial responsibility levels by DOT where a need for such levels is clearly demonstrated and at an amount which will not be injurious to small business.

Respectfully submitted,

Daniel N. Myers
Vice President, Government
Relations & General Counsel

DNM:pc

National LP-Gas Association · 1301 West 22nd Street · Oak Brook, Illinois 60521 · 312-986-4800

URGENT

The following survey data are urgently needed to help NLPGA work on amendments to the Motor Carrier Act financial responsibility requirements. The survey is anonymous. If you do not have precise answers, a best estimate is better than no answer. Please respond by February 29, 1984. Thank you.

1. How many years have you been in business? __________
2. How many gallons of propane do you sell annually? __________
3. Approximately how many miles do your trucks travel annually? __________
4. How many customers are serviced by truck delivery? __________
5. How many trucks over 3500 gal. w.c. do you operate? __________
6. How many trucks over 10,00 lb. gvwr and less than 3500 gal. w.c. do you operate? __________
7. Do any of the trucks in question 6 cross state lines? __________
8. How much do you spend or budget annual for:
   a truck maintenance __________
   b truck purchases __________
   c driver training __________
   d safety training __________
   e vehicle insurance __________
9. What are your current insurance limits? __________

Estimated Average Cost of Minimum Liability Insurance

Limit	High Rate Arlington, VA	Average Rate Omaha, NE	Low Rate Dayton, OH
25,000 CSL	$2,063	$1,688	$1,343
100/300/50	3,402	2,784	2,215
Additional Charges for:			
500,000 CSL	$ 394	$ 322	$ 256
750,000 CSL	600	491	390
1,000,000 CSL	786	643	511
5,000,000 CSL	2,003	1,638	1,304

10. Based upon your insurance agent's estimate or the above table choosing the city most like your area if necessary, how much would your annual premiums increase if you had to carry 1 million dollars for all trucks under 3500 gal. and 5 million dollars for all trucks over 3500 gal. ______________________
11. Assuming you are required to increase your insurance premiums to the amount in question 10, in what portion(s) of your operations, if any, would you be forced to reduce expenditures? ______________________
12. How many accidents involving your trucks have you had over the last 10 years? __________
13. What was the largest payment to an injured party? Truck accidents only. ____
14. List the number of judgements, settlements or claims paid from truck accidents in last 10 years by the following gategories:

Dollar Size	Number	Dollar Size	Number
Under $5,000	____	$100,001 - 300,000	____
5001 - 50,000	____	300,001 - 1,000,000	____
50,001 - 100,000	____	1,000,001 - 5,000,000	____

15. How many of the above accidents involved loss of product. __________
16. Have you ever had a truck accident in which propane loss/spill contributed to personal and/or property damages? Yes ___ No ___
    If yes, year(s) and amount(s) of judgement or settlement. ____________________

PLEASE FOLD OVER, STAPLE, STAMP AND MAIL IMMEDIATELY

RESOLUTION
# of the
NATIONAL MOTOR CARRIER ADVISORY COMMITTEE
to the
FEDERAL HIGHWAY ADMINISTRATION

Approved January 31, 1986

Whereas the National Motor Carrier Advisory Committee has received information and evidence that there is a "liability insurance crisis" in America today; and,

Whereas it appears to the Committee that although all businesses appear to be affected, the motor carrier industry is particularly hard hit; and,

Whereas the Committee believes that the hazardous material motor carrier industry is severely handicapped through operation of Section 30 of the Motor Carrier Act requiring up to $5 million financial responsibility to compensate for undefined "environmental restoration" and other damages; and,

Whereas the Committee believes that without change in the requirements of Section 30 some carriers of hazardous materials either may have to operate illegally or park their trucks and deny vital motor fuels, heating fuels, and other hazardous materials to their customers this winter;

Now, therefore, be it resolved that the National Motor Carrier Advisory Committee urges the Administrator of the Federal Highway Administration and the Secretary of the U.S. Department of Transportation to take such steps as necessary to encourage Congress to review the provisions of Section 30 of the 1980 Motor Carrier Act specifically including appropriate levels, categories, definitions, the concept of joint and several liability, and proofs of insurance in this time of crisis; and,

Be it further resolved that this Committee requests the Administrator of the Federal Highway Administration to transmit a copy of this Resolution to the appropriate Committees of Congress in order to impress upon them the seriousness of this crisis.

NATIONAL MOTOR CARRIER ADVISORY COMMITTEE
MEMBERSHIP LIST

ALLEN, John M. - Commissioner, Arkansas Transportation Commission, Justice Building, Little Rock, Arkansas 72201

BOSTICK, JR., William G. - Senior Vice President, Commercial Carrier Corporation, 502 East Bridgers Avenue, P.O. Drawer 67, Auburndale, Florida 33823

BRADY, Charles - Staff Director, Legislative Affairs, American Automobile Association, 8111 Gatehouse Road, Falls Church Virginia 22047

BRADY, John J. - President and Chief Operating Officer, Standard Fusee Co., Inc., Jackson Division, P.O. Box 1047, Easton, Maryland 21601

CLAPP, Joseph M. - Vice Chairman - Corporate Services, Roadway Services, Inc., 1077 Gorge Boulevard, P.O. Box 88, Akron, Ohio 44309-0088

DONOHUE, Thomas J. - President and Chief Executive Officer, American Trucking Associations, Inc., 2200 Mill Road, Alexandria, Virginia 22314

DURHAM, Ralph V. - Director, Safety and Health, International Brotherhood of Teamsters, 25 Louisiana Avenue, NW., Washington, D.C. 20001

FARRELL, William E. - Owner-Operator, 12255 Flora Drive, Missoula, Montana 59801

FITZGERALD, Joy - Independent Truckers Association, Joy B. Fitzgerald, Inc., Box 36 (Interstate 80 & Exit 143), Altoona, Iowa 50009

GRISKIVICH, Peter - Vice-President and Director, Motor Truck Manufacturers Division, Motor Vehicle Manufacturers Association, 1620 Eye Street, NW., Suite 1000, Washington, D.C. 20006

JOHNSON, Lucien B. - Executive Vice President, Government Relations Associates, Ltd., 237 Shady Lane, Salem, Illinois 62881

JOHNSTON, James J. - President Owner-Operators Independent Drivers Association of America, P.O. Box 88, Oak Grove, Missouri 64075

KYNASTON, Edward E. - Executive Director, Commercial Vehicle Safety Alliance 8751 Sapphire Court, Elk Grove, California 95624

MCDANIEL, Charles G. - President, Hildrup Transfer & Storage Company, 300 Central Road, P.O. Box 745, Fredericksburg, Virginia 22404

MYERS, Daniel N. - Vice-President, Government Relations and General Counsel National LP-Gas Association, 1235 Jefferson Davis Highway, Suite 702, Arlington, Virginia 22202

PHEMISTER, Thomas A. - Director, Bureau of Explosives, Association of American Railroads, 1920 L St., NW., Washington, D.C. 20036

SCHUMACHER, Thomas C. - Executive Vice-President, California Trucking Association, 1251 Beacon Boulevard, West Sacramento, California 95691

SMITH, Wayne J. - Executive Director, United Bus Owners of America, 1275 K Street, NW., Suite 800, Washington, D.C. 20005

SWENNES, Thomas R. (Dick) - Vice President & General Manager, Port Service Company, P.O. Box 03238, 6347 North Marine Drive, Portland, Oregon 97203

WILSON, Don A. - General Manager, Surface Transportation Group, CITGO Petroleum Corp., P.O. Box 7002, Addison, Texas 75001

Liaison Members (Nonvoting Members)

DOWD, Allen D. (CHAGNON, Paul R. (alternate)) - Military Traffic Management Command, Department of the Army (Department of Defense), Washington, D.C. 20315

FITZPATRICK, Martin - Director, Office of Transportation, U.S. Department of Agriculture, Auditor's Building, Room 1405, 14th & Independence Avenue, SW., Washington, D.C. 20250

MORELL, Karlheinz - Attorney Advisor to the Chairman, Interstate Commerce Commission, Room 3219, 12th Street & Constitution Avenue, NW., Washington, D.C. 20423

Executive Director

STAPLETON, James J. - Federal Highway Administration, Office of the Chief Counsel, 400 Seventh Street, SW., (HCC-20), Washington, D.C. 20590

11/85

MSAIA
Minnesota Society
American Institute of Architects

275 Market Street
Suite 54
[illegible] MN

February 25, 1986

Bob Wilson
Small Business Committee
SR 428A
Washington, DC 20510

Dear Mr. Wilson

To follow up on our discussion of a week ago I am enclosing information to be included in the written material resulting from the hearings on Tort Law Reform. I have enclosed a statement prepared by our national organization, The American Institute of Architects, on "Professional Liability". In addition there is a copy of a questionnaire that we sent to Minnesota architectural firms. Included with that is a digest of statistics prepared from the responses we received from those firms.

The liability issue is a serious concern for architects, and the current situation has an adverse affect on the way firms do business in Minnesota and across the country. Since the problem affects many professions as well as the public we must all do what we can to change the situation. If you have any questions or need more information, please call on me or my partner Peter Rand at the above location, or call on John Lynn, Government Affairs Department at The American Institute of Architects in Washington (202-626-7374).

Sincerely

Beverly E. Hauschild

Beverly E. Hauschild
Executive Director

cc: John Lynn, Administrator for Government Affairs
The American Institute of Architects

[illegible] BLE

MSAIA
Minnesota Society
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February 28, 1986

SUMMARY

Professional Liability Insurance Survey

In February 1986 MSAIA conducted a survey of architectural firms with regard to their experience with professional liability insurance. Specifically, we wanted to know how many firms were "going bare" and what kind of premium increases firms with insurance were experiencing. Attached is a copy of a questionnaire that was mailed to principals of architectural firms who are members of MSAIA. 230 questionnaires were sent out.

In order to receive the information quickly, we asked that the firms respond by telephone. The tabulated results of this survey are also attached.

24 of the responding firms indicated that they do not currently have professional liability insurance. Only one firm has more than 5 staff persons and all the firms offer only architectural services in-house. As might be expected, these firms are small with an average size of 3 and a median size of 2 staff persons. Similarly, the firms are generally younger with an average of 8 years (distorted because one firm is 50 years old) and a median age of 3 years.

97 of the responding firms indicated that they currently have professional liability insurance. As might be expected, this group included the larger firms and multi-discipline, architect-engineer firms. Collectively, these firms represent 1,576 jobs and over 1,500 years of practice experience. And while insurance limits, deductibles, and premiums vary, they pay a total of $2,809,000 in professional liability insurance premiums. That is an average of $1,782 in premium per staff person, or $29,000 per firm. The average firm size is 16.2 staff persons with 7 staff being the median. In terms of experience, the average is 15.7 years per firm with 11 years being the median.

While 7 different insurers cover these firms, Imperial Casualty has over half the firms in this market. Since firms have modified their deductibles and limits in order to reduce the premiums, it is not possible to identify what the average increase has been in the cost of professional liability insurance. As the data indicates, however, over half the firms have had premium increases that they are actually paying which are more than 100% higher than last year. The highest premium increase was 700%.

Conclusions:

It is, of course, dangerous to draw conclusions from such an informal and quick survey. Nevertheless, some general characterizations can be made.

1. Small and/or young firms do not obtain professioanl liability insurance. This is probably due to limited need in terms of assets to protect and of projects which generate an exposure.

2. Multi-discipline firms invariably obtain insurance. This can be attributed to their age and size as well as their broadened exposure caused by providing a broader range of services.

3. Firms which have had small increases in premiums (less than 100%) have probably either not yet been impacted by recent premium increases or have reduced their premiums by reducing their limits of coverage and increasing their deductible. When firms reported small increases, we asked why and they always reported that they changed their coverage to reduce premium.

4. Study of the data indicates that the insurance is slightly more expensive for smaller firms than it is for larger firms. This may be attributable to the fact that larger firms are usually older and have a longer track record of experience for basing premiums on.

5. At an average of almost $1,800/staff person, this insurance is a very major portion of a firm's overhead and probably exceeds the cost of many other overhead items. E.G. we know of no firm which pays this amount for health insurance per employee.

6. The 100 firms not responding to the survey would appear to be smaller firms which we would assume do not have professional liability insurance. If they had it, they would undoubtedly want to share their experience in order to gain a perspective. And, since the MSAIA staff is familiar with most of the firms and since almost all the firms responding indicated who they were, we can report with certainty that the larger firms, those with over 15 personnel, invariably have professional liability insurance.

Peter Rand, AIA
Executive Director

MSAIA
Minnesota Society
American Institute of Architects

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(612) 338-6763

February 11, 1986

Dear Firm Principal:

HELP!!!!

While MSAIA leadership was in Washington for the annual Grassroot meetings, arrangements were made for MSAIA to offer testimony to Senator Rudy Boschwitz' Small Business Committee on the current Professional Liability Insurance crisis. To have an impact, we need some quick statistics.

Please read the questions below and PHONE IN your responses to MSAIA. We'll report the results to everyone in the next issue of Communications. You need not give the name of your firm although it would be helpful for our records and would be kept totally confidential. You need not give your answer to any particular staff person, all of us will be ready to take down the information.

The rush in this is caused by the fact that the hearings will be held next week, Thursday and Friday. We will send this information to Washington and have a member of AIA's Governmental Affairs department convey our testimony.

1. Does your firm have professional liability insurance? Yes/No
2. How many years has your firm as presently constituted been in business? _____
3. How many total staff do you have? _____
4. Do you have in-house engineering staff? Yes/No
5. If you have professional liability insurance,
   a. What was the percentage increase in your premium the last time renewed? ____%
   b. What is your current liablity insurance premium? $________
   c. What is the limit of your coverage (e.g. $1 million? $.5 mill?, etc.) $__________
   d. What is your deductible? $__________
   e. Who is your insurer? _______________

Thanks for your cooperation. Just call MSAIA at 612/338-6763. We must have this information no later than NOON, Monday, February 17!

Peter
Peter Rand, AIA
Executive Director

Beverly
Beverly Hauschild
Executive Director

PROFESSIONAL LIABILITY INSURANCE SURVEY

2/21/86

FIRMS WITH LIABILITY INSURANCE

Page 1 of 4

# OF STAFF	AGE OF FIRM	A/E	% CHANGE IN PREMIUM	($1,000's) PREMIUM	($Mill's) LIMIT	($1,000's) DEDUCTIBLE	CARRIER
187	33	Yes	140	285.3	5.0	50	Imperial
140	70	Yes	300	150.0	2.0	50	Imperial
125	30	Yes	30	375.0	2.5	100	CNA
102	25	Yes	110	137.5	2.5	75	Imperial
100	12	Yes	700	140.0	2.0	35	Continental
65	8	No	207	112.0	2.0	50	Imperial
56	15	No	500	200.0	1.0	100	Continental
41	30	Yes	58	52.0	.5	25	Imperial
40	84	Yes	243	94.0	.5	25	Continental
31	10	No	267	24.0	1.0	10	Imperial
30	30	Yes	46	58.0	1.0	15	Imperial
25	30	Yes	80	40	.5	20	Imperial
25	23	No	47	59.0	2.0	20	Imperial
23	10	Yes	150	84.0	1.0	10	Gen Accident
20	15	No	48	26.0	1.0	15	Imperial
20	12	Yes	60	28.0	.5	15	Republic
20	5	No	300	18.0	1.0	15	Imperial
18	30	No	14	21.0	.5	15	Republic
18	1	No	0	13.0	1.0	10	Imperial
17	25	No	300	17.6	.25	10	Republic
17	10	No	128	21.0	.5	10	Imperial
17	5	No	450	22.0	.5	10	Gen Accident
16	30	No	46	44.0	1.0	15.	CNA
16	12	Yes	380	62.0	1.0	10.	Imperial
14	23	No	103	24.0	.5	10.	Imperial
13	14	No	80	14	1.0	5	?
12	18	No	25	6.4	.25	15	Gen Accident
12	8	No	52	17.6	.75	10	Imperial
12	5	No	300	17.0	.5	10	Republic
11	3	No	200	8.0	.25	5	Imperial
10	14	No	250	15.0	1.0	10	Imperial
10	13	No	65	14.8	.5	7.5	Imperial
10	13	No	150	6.7	1.0	5	Imperial
10	2	No	133	16.5	1.0	10	Imperial

PROFESSIONAL LIABILITY INSURANCE SURVEY

2/21/86

FIRMS WITH LIABILITY INSURANCE

Page 2 of 4

# OF STAFF	AGE OF FIRM	A/E	% CHANGE IN PREMIUM	($1,000'S) PREMIUM	($MILL'S) LIMIT	($1,000'S) DEDUCTIBLE	CARRIER
9	38	No	40	21.0	.5	6	CNA
9	23	No	100	30	.5	20	CNA
9	10	No	0	17.6	.5	5	DPIC
9	9	No	100	12.0	.1	15	?
8	37	Yes	320	31.0	1.0	8	CNA
8	23	No	400	23.0	.5	10	Imperial
8	9	No	60	7.3	.5	5	Imperial
8	8	No	580	23.4	.5	5	CNA
7	26	No	94	17.0	1.0	10	Imperial
7	25	No	66	10	.25	5	DPIC
7	8	No	50	7.5	.5	5	Imperial
7	1	No	50	7.5	.5	5	Imperial
6	28	No	16	10	.5	5	Imperial
6	28	No	64	10.5	.5	5	Republic
6	23	No	350	10.0.	.25	5	Gen Accident
6	23	No	250	19.4	.25	5	Imperial
6	18	No	20	5.5	.5	5	Imperial
6	18	Yes	115	6.5	.25	5	Imperial
6	17	No	49	13.0	1.0	7.5	Imperial
6	13	No	120	15	1.0	5	Imperial
6	10	No	400	25.0	1.0	5.	CNA
6	7	No	120	14.7	1.0	10	TIFCO
6	7	No	173	5	.25	5	Imperial
6	4	No	200	15.7	.5	5	DPIC
6	3	No	10	9.5	.25	5	DPIC
6	3	No	75	2	.1	5	Imperial
5	16	No	460	14.0	.1	5	CNA
5	15	No	250	16.5	.1	6	CNA
5	35	No	50	3.8	.1	5	Imperial
5	20	No	300	11.8	.1	5	CNA
5	7	No	200	11.0	.25	10	Republic
5	6	No	24	1.4	.1	5	Imperial
5	4	No	164	7.0	.25	5	Republic
4.5	6	No	29	3	.25	5	Imperial
4.5	3	No	104	6.1	.5	5	Republic
4.5	1	No	0	3.4	.1	5	Lloyds
4	100	No	100	9.5	.5	5	DPIC

PROFESSIONAL LIABILITY INSURANCE SURVEY

2/21/86

FIRMS WITH LIABILITY INSURANCE

# OF STAFF	AGE OF FIRM	A/E	% CHANGE IN PREMIUM	($1,000'S) PREMIUM	($MILL'S) LIMIT	($1,000'S) DEDUCTIBLE	CARRIER
4	32	No	10	1.2	.25	2	CNA
4	30	No	118	24.0	1.0	5	CIGNA/INA
4	8	No	30	6.5	.5	5	Imperial
4	4	No	15	6.0	.1	10	Imperial
3	10	No	100	6	.1	6	Gen Accident
3	9	No	250	7	.25	10	Republic
3	5	No	60	8	.1	5	Lloyds
3	3	No	80	3.1	.25	5	Imperial
3	3	No	44	3.4	.5	5	Imperial
3	3	No	300	7	.25	10	Republic
3	2	No	63	3.8	.5	5	Republic
3	2	Yes	34	4	.5	5	Lloyds
2	13	No	25	2.6	.25	5	Imperial
2	10	No	350	7.1	.1	5	CNA
2	8	No	20	5.0	.5	5	Imperial
2	6	No	22	3.5	.25	5	Republic
2	5	No	150	3.0	1.0	5	IMI
2	5	No	290	4.3	.1	2	CNA
1.5	33	No	100	3.3	1.0	10	CNA
1	9	No	30	1.4	.1	2.5	Imperial
1	6	No	0	2.6	.25	2.5	Imperial
1	5	No	0	1.6	.1	4	Lloyds
1	5	No	50	2.4	.5	2.5	Imperial
1	5	No	100	2.5	.25	2.5	Imperial
1	3	No	25	1.5	.1	2.5	Imperial
1	2	No	0	14.0	1.0	4	CNA
1,576	1,526			$2,809.6			
16.2	17.5 yrs.			$29,000			
7	11 yrs.			$1,782/Staff Member			

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PROFESSIONAL LIABILITY INSURANCE SURVEY

2/21/86

MSAIA FIRMS WITH NO INSURANCE

# OF STAFF	AGE OF FIRM	A/E
13	8	No
5	18	No
5	3	No
5	3	No
4	1	No
4	3	No
4	8	No
3	2	No
3	2	No
3	1	No
2	1	No
2	22	No
2	4	No
2	18	No
2	8	No
2	50	No
2	2	No
2	13	No
1	16	No
1	2	No
1	4	No
1	2	No
1	1	No
1	8	No
71	200	
3	8.5 yrs.	
2	3 yrs.	